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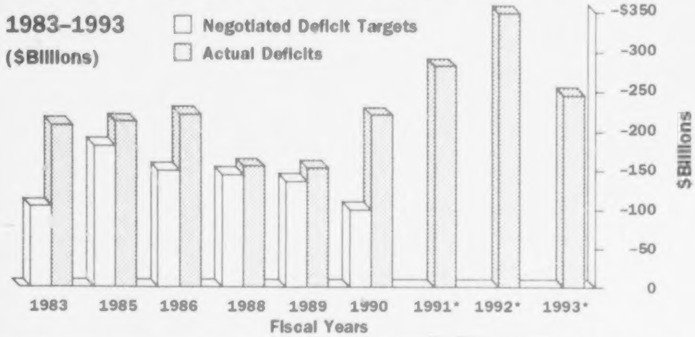
Tax Features

FY'91 Ends on Failing Budget Deal; Deficits and Spending Soar

When fiscal year 1991 closed on September 30th with a deficit $60 billion higher than last year's, American taxpayers had learned another hard lesson from the budget summiteers, the President and the Congress. This is the conclusion of a new Tax Foundation Issue Brief titled, *Budget Deal Perpetuates Fiscal Failure*, by Paul G. Merski. As a result of last fall's budget summit, $164 billion in new taxes were raised and promises of spending restraint made, but instead of spending restraint, taxpayers are stuck with a higher tax burden, higher spending, record deficits and a national debt of heroic proportions. Put simply, last year's budget "deal of the century" was not a good deal for the American taxpayer.

FAILED BUDGET DEALS:
Negotiated Deficit Targets vs. Actual Deficits



*Fixed deficit targets eliminated. Estimates from OMB Mid-Session Review (see table 1 on p. 3).
Source: Tax Foundation.

Look Back At OBRA'90

The product of intense and prolonged budget summitry between President Bush and congressional leaders, the Omnibus Budget Reconciliation Act of 1990 (OBRA'90) promised $500 billion in deficit reduction over five years. But after only one of those five years has passed, it is already clear the U.S. is in store for the three largest annual deficits in history. For the entire

See Budget Summitry on page 3

Tax Foundation

IN THIS ISSUE

Budget Deal Review 1
"Front Burner" 1
State Tax Collections 4
Compliance Seminar 5
Pennsylvania Tax Seminar 5
O'Neill to Receive Award 7
Foundation Message 7
Moscow Business Conference 8

FRONT BURNER

Needed: Stability in Tax Policy

Sen. John Danforth

Each year, taxpayers must guess whether important tax incentives referred to as "extenders" will remain in Federal tax law. In a ritual that is almost institutionalized, members annually proclaim support for their favorite extender provision(s), but fail to act in a timely manner to keep the provisions in force. This year is no different.

Housing Incentives

Many of these provisions have been exceptional tools to encourage beneficial social and economic activities. Their continued existence is absolutely essential. For example, the Low Income Housing Tax Credit (LIHTC) program provides a tax credit for acquisition, rehabilitation and construction of low-income housing. The LIHTC is to expire on December 31, 1991. Since its enactment in 1986, the program has become the principal federal incentive for the production of low-income housing.

Through the credit, state housing finance agencies have helped finance more than 365,000 low-income rental units since 1986, including 126,200 in 1989. In 1989 and 1990, when new multifamily construction was declining across the board, the credit was responsible for approximately 25 percent of all multifamily rental starts. Moreover, credit-assisted production accounts for between 95 and 100 percent of low-income multifamily rental production (units that rent for less than $450/month). The National Association of Home Builders (NAHB) estimates that the credit will result in preservation of 620,000 low-income units in the next decade, and production of 640,000 new low-

See Danforth on page 2

Senator John C. Danforth, Republican from Missouri, is a member of the Senate Finance Committee and Ranking Minority Member of its Subcommittee on International Trade.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Danforth from page 1

income rental units.

The LIHTC has benefits extending beyond providing housing for low-income individuals. Growth in housing stock also is a tool to revitalize local economies. NAHB estimates that the LIHTC generates $140,000 of economic activity per housing unit. In addition, increased wages, property values and tax revenues from increased activity add an estimated $16.8 billion to the economy and $1.2 billion in tax revenues annually.

Planning, structuring and building a tax credit project is complicated, time-consuming and costly. A developer has little incentive to invest in such projects unless the credit is assured of continuing through the life of the project. In addition, much of the money generated for tax credit projects is accumulated through pooled equity funds. The constant uncertainty surrounding the credit's extension stifles investment in these sources of capital. A lapse in the program will severely damage investor confidence. Moreover, Congress has asked state agencies to assume major new responsibilities for the credit, but with no certainty that the program will continue.

Members annually proclaim support for their favorite extender provision(s), but fail to act in a timely manner to keep the provisions in force. This year is no different.

For these reasons, I remain firmly committed to permanent extension of the low-income housing tax credit program. Including myself and Senate Majority Leader George Mitchell, there are 83 Senate cosponsors of legislation to make the credit permanent.

A related provision to encourage housing for middle- and low-income taxpayers also is set to expire at the end of 1991. That provision provides for issuance of qualified mortgage bonds, the proceeds of which are used to finance the purchase (or qualifying rehabilitation or improvement) of single-family, owner-occupied homes within the jurisdiction of the bond issuer. (Because the interest earned on these bonds is exempt from federal income tax, the bonds provide mortgage money at lower than conventional rates.) Ninety-five percent of the bonds issued must provide funds to finance residences for mortgagors who have had no present ownership interest in a principal residence during the three-year period before execution of their respective mortgages. Along with 88 Senators, I support permanent extension of this provision.

Jobs for People with Special Needs

Another important program that will lapse at the end of the year unless action is taken by Congress is the Targeted Jobs Tax Credit (TJTC), which encourages employers to hire persons from targeted groups with special employment needs.

Over the past decade, TJTC has placed well over five million unemployed workers in private sector jobs. Last year's General Accounting Office (GAO) report on TJTC demonstrated that the credit has helped to change hiring practices and to stimulate managers to seek out, recruit, hire and retain employees of the targeted groups.

It is imperative that there be no lapse in the TJTC program. Retroactive reauthorization fails those who need it in the interim. Especially now, with current hiring levels making it more difficult for those with less skill and training to get jobs, TJTC offers disadvantaged people a chance to compete in the job market.

In addition, Job Services offices will not process letters of request for certification if there is a lapse in the program. Moreover, absent a TJTC, state agencies responsible for administering the credit will be idle, and perhaps closed. With 46 Senate colleagues, I have sponsored legislation to make the TJTC permanent.

America's Competitive Edge: R&D

American businesses would be disadvantaged by a lapse of tax incentives to spur research and development (R&D). International competition is a major challenge to the continued growth and vitality of domestic corporations. The quality and extent of domestic research and development is vital to the ability of U.S. businesses to remain competitive in international markets. Japan and Germany spend approximately one-third more of national income to develop commercially useful processes and technologies than does the U.S.

Congress has recognized the need to encourage domestic R&D spending. As a result, the R&D tax credit was developed in 1981 and has remained in the law since then. To maintain the R&D tax credit, Congress has on four occasions enacted extensions. It should not be necessary for Congress to vote on this issue annually. Yet, current budget procedures make it difficult to enact any tax bill, even one as important to our economy as the R&D credit.

Accordingly, Senator Baucus and I have introduced a bill to make permanent the R&D credit. The majority of the Senate has agreed to cosponsor this bill.

Charitable Giving

For a number of charitable organizations, gifts of appreciated property have declined since 1986, when the unrealized appreciation such gifts was made a tax preference item for purposes of the alternative minimum tax (AMT). This change in law directly and negatively affected gifts given to colleges and universities, which use such gifts for scholarship funds, endowed chairs, construction and renovation of classrooms and laboratories.

In 1990, the unrealized appreciation with respect to charitable contributions of tangible personal property was excepted from the AMT calculation. This provision is set to expire at the end of 1991. Accordingly, I have introduced legislation to encourage charitable giving by removing all gifts of appreciated property from the AMT.

Miscellaneous Incentives

Other socially beneficial tax provisions are to expire at the end of 1991. I have supported and cosponsored bills to make permanent the deduction for health insurance costs for self-employed individuals, as well as the exclusion from gross income of the cost of educational assistance to employees. Each of these provisions was enacted many years ago with sunset provisions, and has been extended by Congress numerous times.

It is time to commit ourselves to a stable and predictable policy with respect to these tax incentives. The decision should be made sooner, rather than later. These provisions have demonstrated their worth time and time again. Putting off a decision to make them permanent, yet again, merely undermines their effectiveness today. ■

Budget Summitry from page 1

five-year period governed by the agreement, an estimated $1.08 trillion will be added to the national debt. Last year's agreement contained a little-noticed provision that boosted the federal debt limit more than a trillion dollars to $4.145 trillion. But at the current pace of our deficit spending, the debt ceiling will be surpassed before FY'93, forcing the statutory debt limit to be raised yet again.

The rapidly rising net interest payments on this debt are reaching staggering proportions. In FY'92 alone, net interest on the debt will cost over $200 billion (see table 2). This amounts to 15 cents of every tax dollar sent to Washington and will cost the typical family of four $2,238 in taxes. These interest costs keep taxpayers spinning in the vicious cycle of higher taxes, higher spending, higher deficits, higher debt, and higher interest payments – leading back to higher taxes.

OBRA'90 dismissed deficit targets as a budgeting tool, replacing them with fixed annual spending caps on defense, international and domestic discretionary spending. But despite these much-vaunted spending caps, federal spending will consume a peacetime record 24.9 percent of the gross national product (GNP) in FY1992. The associated flow of deficit red ink will reach a staggering 5.9 percent of GNP, a level exceeded only once since World War II, in 1983.

Table 1

Failed Budget Deals: Negotiated Deficit Targets vs. Actual Deficits

1982–1990

($Billions)

Negotiation Year	Fiscal Year	Negotiation's Target	Actual Deficit
1982	FY'83	–$104	–$208
1984	FY'85	–181	–212
1985	FY'86	–150	–221
1987 (a)	FY'88	–144	–155
	FY'89	–136	–153
1989	FY'90	–100	–220
1990 (b)	Deficit targets eliminated		
	FY'91 (c)	-	–282
	FY'92 (c)	-	–348
	FY'93 (c)	-	–245

(a) Two-year agreement.
(b) Five-year agreement
(c) OMB 1991 Mid-Session review estimates.
Source: Tax Foundation.

The latest Office of Management and Budget figures show that the cumulative deficit for fiscal years 1991-1995 will be $555 billion higher than promised last September. This failure is largely due to the absence of anything in last year's budget agreement that will restrain the largest and fastest growing components of the federal budget. Entitlement spending and net interest payments on the debt comprise nearly 65 percent of total outlays, yet they are completely exempt from any spending caps. This "mandatory" spending will be allowed to climb an average of over 8 percent annually through 1996, more than double the projected rate of inflation during the same period.

Clearly there is little hope of reducing the deficit when 65 percent of spending is left unchecked. This is evident in the $252 billion re-estimate of deficit projections just since the February 1992 Federal Budget release. These higher deficits were primarily fueled by additional five-year cumulative spending increases of $64 billion in Medicaid, $39.2 billion in debt interest, and $11.7 billion in unemployment and food stamps.

Why Budget Deals Have Failed

Last year's budget deal's failure to control Uncle Sam's spendthrift ways comes as no surprise to experienced observers of budget summitry. Budget deals in 1982, 1984, 1985, 1987, and 1989 all fell far short of their stated goals (see table 1 and chart on page 1). OBRA90 may be a different approach to deficit reduction, but its results have been the same: higher taxes, higher spending and higher deficits.

Ironically, fiscal years not preceded by budget summits actually produced the most real deficit reduction. In FY'84, the deficit dropped $23 billion when spending growth was held to 5.4 percent – half the rate of revenue growth, and in FY'87, spending grew only 1.4 percent, enabling the budget deficit to fall a record $71.5 billion.

The new Foundation report (8pp., $5 + $2 p/h) cites three important reasons why budget summits have failed:

When the deficit reduction gets tough, the "tough" change the rules. Frustration with persistent budget deficits had provoked the passage of the original Gramm-Rudman-Hollings law (GRH-I) that promised a balanced budget by 1991, but when the time came for the promised spending cuts, lawmakers avoided any tough choices by raising taxes, rewriting GRH-I, and promising a balanced budget two years down the road in 1993 under GRH-II. When the bite in GRH-II would have forced spending restraint, it was time to rewrite the rules again, and the promised balanced budget was pushed back to 1996.

Table 2

Gross Federal Debt, Public Debt, and Interest Payments

Fiscal Years 1980-1992

($Billions)

Year	Public Debt	Gross Federal Debt	Federal Net Interest Payments
1980	$709.3	$908.5	$52.5
1981	784.8	994.3	68.7
1982	919.2	1,136.8	85.0
1983	1,131.0	1,371.2	89.8
1984	1,300.0	1,564.1	111.1
1985	1,499.4	1,817.0	129.4
1986	1,736.2	2,120.1	136.0
1987	1,888.1	2,345.6	138.6
1988	2,050.3	2,600.8	151.7
1989	2,190.3	2,867.5	169.2
1990	2,410.4	3,206.3	184.2
1991	2,717.6	3,617.8	197.0
1992	2,995.4	4,021.1	206.3

Source: Office of Management and Budget.

Tax increases which take effect immediately are paired with pledged spending reductions in future years. Every budget summit deal has included significant tax increases, and last fall's $164 billion in additional revenues over five years was the second largest tax increase in history. This was "balanced" with large amounts of projected government scrimping and saving, but unlike new taxes which are collected as soon as they're enacted, long-term spending cuts demand constant discipline that has not been witnessed over the past decade. The only spending cuts that can be counted on are cuts in the current fiscal year, not promised future cuts from built-in spending increases.

Government spending has outpaced both revenues and inflation. Between FY'81 and FY'91, revenues have grown a hefty 78.3 percent, but spending levels doubled, rising 22 percentage points faster than revenues. Spending growth averaged 7.9 percent annually, a full 3.2 percentage points higher than needed to keep pace with the decade's 4.7 percent average inflation rate. Clearly, the deficit cannot be reduced if spending is allowed to outpace the growth in revenues and inflation.■

State Tax Collections Break $300 Billion Mark in FY'90

State tax revenues broke the $300 billion barrier in FY 90, up 5.7 percent to $300.5 billion from $284 billion in FY 89, according to a new Tax Foundation Special Report titled *Survey of State Tax Rates and Collections* by Gregory S. Leong.

Revenue from severance, property, and death and gift taxes grew the fastest, but most of the new funds came from the mainstays of state government finance—personal income tax and general sales tax. State government's take from personal income rose 8.2 percent to $96.1 billion, while sales tax revenue rose 6.0 percent to $99.7 billion. Together they accounted for more than 55 percent of the tax pie. The third most prodigious revenue producer for state governments is corporate income taxes, which have been increasing rapidly and represented 7.3 percent of total collections in FY 90, or $22 billion.

Over the course of the 1980s, state tax collections grew at an average rate of 8.6 percent, outpacing inflation by more than 3 percentage points and personal income by 0.9 percentage points. Personal income, insurance, and sales taxes grew the fastest, jumping 159 percent, 158 percent, and 151 percent respectively.

Tax Burden Per Capita

The average state tax burden per capita rose $62, from $1,148.52 in FY 89 to $1,211.14 in FY 90. Alaskans paid the highest per capita taxes in the country, $2,811.49 per resident. Hawaii ($2,106.78), Delaware ($1,695.59), and Connecticut ($1,602.62) rank two, three, four in taxes per person. Taxpayers in New Hampshire ($536.67), South Dakota ($718.52), and Texas ($866.36) will shoulder the lightest per capita state tax burdens (see table at right).

Taxes Per $1,000 of Personal Income

In state level taxes, taxpayers paid a national average of $64.87 per $1,000 of personal income earned, or an average effective rate of 6.49 percent. Thirty-one states and the District of Columbia surpassed this national average rate. Alaska, second only to the District of Columbia, had the highest effective rate, 12.9 percent, nearly double the national average. By comparison, taxpayers in New Hampshire paid 2.6 percent of their personal income in state taxes. The ten states which take the highest percentage of personal income were:

Alaska	12.9	Minnesota	8.3
Hawaii	10.4	Wyoming	8.2
New Mexico	9.3	Washington	8.1
West Virginia	9.0	Kentucky	7.7
Delaware	8.5	Wisconsin	7.7

In contrast, the ten states in which taxpayers paid the lowest effective tax rates per $1,000 of personal income were:

New Hampshire	2.6	New Jersey	5.4
South Dakota	4.5	Tennessee	5.5
Colorado	5.0	Missouri	5.5
Texas	5.2	Florida	5.5
Virginia	5.4	Illinois	5.6

[This annual review of state tax developments ([illegible]pp., $5 + $2 p/h) can be ordered by phone or mail.] ■

Total State Level Tax Collections Per $1,000 in Personal Income and Per Capita Tax Burden

Fiscal Year 1990

State	Per $1000 of Income	Rank Per Capita	Per Capita (a)	Personal Income (b) ($Millions)	Total Tax Revenue ($Millions)
Total	$64.87		$1,211.14	$4,632,380	$300,488.6
Alabama	63.76	44	945.29	59,907	3,819.5
Alaska	129.20	1	2,811.49	11,969	1,546.4
Arizona	73.27	20	1,194.13	59,732	4,376.8
Arkansas	67.65	42	961.80	33,423	2,260.9
California	70.16	9	1,458.98	618,850	43,419.2
Colorado	49.57	45	931.71	61,916	3,069.4
Connecticut	63.20	4	1,602.62	83,355	5,268.0
Delaware	84.62	3	1,695.59	13,349	1,129.6
Florida	55.27	37	1,027.17	240,459	13,289.5
Georgia	64.49	31	1,092.62	109,765	7,078.2
Hawaii	104.02	2	2,106.78	22,446	2,334.8
Idaho	74.61	25	1,131.11	15,262	1,138.7
Illinois	55.55	27	1,127.72	232,071	12,890.5
Indiana	65.26	30	1,100.55	93,494	6,101.6
Iowa	69.17	21	1,193.15	47,897	3,313.1
Kansas	59.89	32	1,077.26	44,562	2,669.0
Kentucky	77.44	24	1,156.13	55,019	4,260.7
Louisiana	67.29	40	968.42	60,730	4,086.7
Maine	73.90	16	1,271.14	21,120	1,560.9
Maryland	61.70	11	1,348.99	104,543	6,450.1
Massachusetts	68.78	7	1,557.26	136,226	9,369.1
Michigan	66.52	19	1,220.34	170,534	11,343.4
Minnesota	83.21	6	1,558.65	81,948	6,819.3
Mississippi	73.11	46	931.08	32,770	2,395.9
Missouri	55.16	41	965.23	89,535	4,939.2
Montana	71.04	33	1,073.36	12,074	857.7
Nebraska	55.66	43	958.53	27,182	1,512.9
Nevada	67.85	15	1,317.39	23,335	1,583.3
New Hampshire	25.82	50	536.67	23,060	595.3
New Jersey	54.06	10	1,349.76	193,008	10,433.9
New Mexico	93.43	14	1,329.34	21,556	2,014.0
New York	72.38	5	1,590.54	395,336	28,614.6
North Carolina	73.23	22	1,186.48	107,403	7,864.7
North Dakota	69.48	35	1,059.97	9,745	677.1
Ohio	60.34	36	1,054.32	189,537	11,436.4
Oklahoma	71.57	29	1,105.31	48,581	3,478.9
Oregon	57.13	39	980.15	48,762	2,785.9
Pennsylvania	59.59	28	1,112.61	221,850	13,219.7
Rhode Island	65.23	18	1,229.05	18,906	1,233.3
South Carolina	74.73	26	1,128.40	52,646	3,934.4
South Dakota	45.27	49	718.52	11,047	500.1
Tennessee	55.09	47	870.38	77,052	4,245.0
Texas	51.70	48	866.36	284,678	14,716.5
Utah	72.87	38	1,026.20	24,263	1,768.0
Vermont	67.85	23	1,183.00	9,812	665.7
Virginia	54.02	34	1,066.77	122,178	6,600.5
Washington	80.88	8	1,525.29	91,774	7,423.1
West Virginia	90.44	17	1,243.25	24,655	2,229.7
Wisconsin	76.59	13	1,340.57	85,620	6,557.7
Wyoming	82.23	12	1,348.39	7,438	611.6
Exhibit: Dist. of Col	157.43		3,806.74	14,676	2,310.3

(a) Population as of June 1990.

(b) Personal income is the sum of the State estimates. It omits the earnings of Federal civilian and military personnel stationed abroad and of U.S. residents employed abroad temporarily by private U.S. firms.

Source: U.S. Department of Commerce, Bureau of the Census, Bureau of Economic Analysis, and Tax Foundation computations.

Seminar Examines Pennsylvania Tax Policy

Pennsylvania's passage in the recently completed legislative session of a budget that will raise $3.3 billion in new revenue occasioned a Tax Foundation conference on state tax policy in Pittsburgh on October 8. Corporate executives, university scholars, concerned taxpayers, and members of the business press met to discuss the role of state tax policy in the local economy.

"Pennsylvania's Ailing Fiscal Condition — Is There a Cure?" was the question posed to the first panel. The subject was addressed by Charles L. Potter, Partner, Rose, Schmidt, Hasley & DiSalle; John Dankosky, Executive Director, Pennsylvania Business Roundtable; Robert P. Strauss, School of Urban and Public Affairs, Carnegie Mellon University; Paul Flora, Regional Economist, PNC Financial Corp.; and Don Eberly, President, The Commonwealth Foundation, with KDKA-TV editor Bill Flanagan moderating.

"Mapping Out Long-Term Policies for Economic Growth" was the theme of the second panel. Chet Wade, Business Editor, Pittsburgh Post-Gazette moderated discussion by Kevin C. Sontheimer, Professor and Chairman of Economics, University of Pittsburgh; Lewis B. Lee, Director - State Division, Pennsylvania Economy League, Inc.; Albert E. Germain, Vice President - Taxes & Tax Counsel, Alcoa; and John D. Luffe, Director of U.S. Taxes, PPG Industries, Inc.

John Fund, an editoral writer for the *Wall Street Journal*, gave a luncheon address on the unresponsiveness of politicians to taxpayer concerns and the resulting deleterious effects on tax policy.

Transcripts are available from the Foundation's offices. ■

▲ ***Luncheon speaker John Fund, editorial writer for the* Wall Street Journal.**

◀ ***From left: Paul Merski, Director of Fiscal Affairs, Tax Foundation; Don Eberly, President, The Commonwealth Foundation; and Kevin Sontheimer, Professor of Economics, University of Pittsburgh***

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▲ ***From left: Dan Witt, executive director of the Tax Foundation, chats with Robert Eberly of Eberly and Meade and John Fund, editorial writer for the Wall Street Journal.***

Foundation to Hold Seminar on Corporate Tax Compliance

In conjunction with the San Francisco and Santa Clara Valley chapters of Tax Executives Institute, the Foundation is presenting a half-day seminar on the subject of corporate tax compliance. The program will be held at the San Francisco Airport Hilton Hotel on Wednesday, December 4, 1991, from 8:30 a.m. to 1:30 p.m. The program represents the initial stage of a major project which the Tax Foundation has undertaken to study the cost and other aspects of corporate tax compliance. The project will include the authorship of a study on the subject by Professor Joel Slemrod, director of the University of Michigan's Office of Tax Policy Research.

See program below; call Ron Bunn with inquiries: 202-863-5454. ■

8:30 a.m.	***Registration***
9:00	***Welcome:*** **W. Ronald Bunn** **Director of Corporate Development, Tax Foundation** ***Session I — Tax Compliance Costs: Industry and Government Perspectives*** ***Moderator:*** **Floyd L. Williams, III** **Chief Tax Counsel, Tax Foundation** ***Industry Panel:*** **Martin Sooper** **Director of Taxes, Pacific Telesis** **Peter Compagna** **Tax Compliance Manager, Intel Corp.** **J.P. LaCasse** **Director of Taxes, American President Cos.** **Richard C. Lam** **Manager – Tax Audit, Chevron Corporation** **Patricia M. Kaltz** **Director of Taxes & Tax Counsel, Nellcor, Inc.** ***Government Panel:*** **John Monaco** **Executive Director, Office of Coordinated Examination Programs, IRS** **Scott McLeod** **Legislation Counsel, Joint Committee on Taxation** **Dianne Sullivan (Invited)** **Tax Legislative Assistant to Congressman Robert Matsui (D-CA)**
10:15	***Coffee Break***
11:30	***Session II — Getting a Fix on the Cost of Compliance*** **Dr. Joel Slemrod** **Director, Office of Tax Policy Research, University of Michigan**
12:30 - 1:30	**Luncheon** ***Speaker:* Robert P. Wayman** **Senior Vice President and Chief Financial Officer, Hewlett-Packard**

Tax Foundation's
43rd National Conference/54th Annual Dinner

Fiscal Policies for the New World Order

Wednesday, November 20, 1991, *The Waldorf-Astoria,* New York City

The Waldorf-Astoria is located at 301 Park Avenue, New York, NY 10022

Registration/Light Fare	12:00 noon	Jade Room
Conference Sessions	1:00 p.m.	Jade Room
Reception	6:00 p.m.	Palm Room
Dinner (Black Tie optional)	7:00 p.m.	Starlight Roof

- Professors and students can participate in the conference through the Foundation's College Classroom Program.
- Hotel room reservation deadline for the Waldorf-Astoria is November 7, 1991. Call the Waldorf directly at 212/872-4534.
- Conference and dinner reservations should be received by November 15, 1991. (Written cancellations for refunds accepted through this date only.)
- Questions about the conference and dinner should be directed to: Dee Dee Hannum, 202/863-5454. Fax 202/488-8282.

12:00	**Registration**	*Light Fare*
1:00	**Welcome**	***Dan Witt*** *Executive Director* *Tax Foundation*
	Session I	***Tax Progressivity - The Facts of the Fairness Debate*** *This session will be devoted to analyzing the distribution of the tax burden among income classes. Will rhetoric or research on the true distribution prevail in the debate on future tax policy?*
	Panel Chairman	***Floyd L. Williams*** *Chief Tax Counsel* *Tax Foundation*
	Speakers	***Bruce R. Bartlett*** *Deputy Assistant Secretary for Policy Analysis* *Department of the Treasury*
		Wendell Primus *Chief Economist* *House Committee on Ways and Means*
		Norman B. Ture *President* *Institute for Research on the Economics of Taxation*
		Paul W. McCracken *Edmund Ezra Day Professor of Business Administration* *University of Michigan*
		Tony Coelho *Managing Director & Chief Operating Officer* *Wertheim, Schroeder & Company*
3:00	**Break**	
3:15	**Session II**	***Tax Policy in a Global Economy - How Well Can the U.S. Compete?*** *This session will explore the role that tax law plays in the ability of U.S. multinationals to compete in a global market, as well as the ability of foreign-owned U.S. corporations to compete in the U.S. Will U.S. tax policy be out of tune with the global economy after European harmonization?*
	Panel Chairman	***William Glasgall*** *International Economics Editor,* Business Week
	Speakers	***Lawrence Kudlow*** *Senior Managing Director and Chief Economist* *Bear Stearns & Co.*
		Alan Auerbach *Professor of Economics* *University of Pennsylvania* *Consultant to the Joint Committee on Taxation*
		Sidney L. Jones *Assistant Secretary for Economic Policy* *Department of the Treasury*
		Ray Haas *International Tax Partner* *Ernst & Young*
5:00	**Adjournment**	

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470 L'Enfant Plaza, SW, #7400
Washington, DC 20024
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Fax : 202/488-8282

Conference Fee:
Member/$100, Non-Member/$125

Reception/Dinner: $250

Paul O'Neill to Receive Distinguished Service Award for Private Sector

Paul O'Neill
Chairman & CEO
Alcoa

Paul O'Neill, director, chairman of the board and chief executive officer of Alcoa, will receive the Tax Foundation's 1991 Distinguished Service Award for the Private Sector at the Foundation's annual dinner to be held on November 20 in New York City. He will be joined on the podium by Senator Max Baucus, whose contributions in the public sector will be recognized.

Mr. O'Neill was serving Alcoa as a director when he was elected chairman and chief executive officer in April 1987.

Prior to joining Alcoa, Mr. O'Neill was president of International Paper Company. He joined International Paper in 1977 as vice president - planning. Four years later, he was named senior vice president - planning and finance, and in 1983, senior vice president of the company's paperboard and packaging segment. Mr. O'Neill was named president in 1985.

He began his career as an engineer for Morrison-Knudsen, Inc., in Anchorage, Alaska. He worked as a computer systems analyst with the U.S. Veterans Administration from 1961 to 1966 and served on the staff of the U.S. Office of Management and Budget from 1967 to 1977. He was deputy director of the OMB from 1974 to 1977.

Mr. O'Neill was born December 4, 1935, in St. Louis, Missouri. He received his B.A. in economics from Fresno State College and a master's degree in public administration from Indiana University. He has participated in graduate programs in economics at Claremont Graduate School and George Washington University.

The award will be presented at a dinner following the Foundation's 43rd annual conference. Panel discussions on tax fairness and global competitiveness will feature the distinguished guests listed on the registration form at left. ■

FOUNDATION MESSAGE

Now Is The Time To Deal With Expiring Tax Provisions

Floyd L. Williams
Chief Tax Counsel

Unless Congress acts by the end of the year, several tax provisions will expire. In fact, one — the rules for allocating and apportioning research expenses — already expired on August 1, 1991. The remaining provisions, which are scheduled to expire after December 31, 1991, are a mixture of exclusions, exemptions, credits, a deduction, and a minimum tax exception.

The expiring exclusions are those for employer-provided educational assistance benefits and group legal services benefits. The expiring exemptions are those for qualified mortgage bonds and qualified small-issue manufacturing bonds. The credits that will not see the sunlight after year's end are the tax credit for qualified research expenditures, the tax credit for low-income rental housing, the targeted jobs tax credit, business energy tax credits for solar and geothermal property, and the tax credit for orphan drug clinical testing expenses. Finally, the deduction for health insurance costs of self-employed individuals and the minimum tax exception for gifts of appreciated tangible property are both set to expire at year's end.

The time has come for Congress to deal with these expiring tax provisions. While the idea of "sunsetting" a provision in order to test its merit may make sense when dealing with a novel matter, most of these tax provisions have been around long enough that they ought either to be extended permanently or allowed to expire and not be resurrected. If allowed to expire, the revenues thus generated could be used for across-the-board tax reduction, thus benefitting the economy as a whole, rather than a particular segment.

As noted by Senator Danforth in the "Front Burner" column (see page 1), each of these provisions has some merit and each has its own constituency. For example, the tax credit for research expenditures encourages American businesses to come up with new innovations and compete better in an increasingly global marketplace. Accordingly, eliminating any one of these provisions would require the Congress to make hard choices.

Decisive Congressional action would add a measure of stability and certainty to the tax law. It is very difficult for businesses to plan more than one year ahead if they do not know whether a tax provision is going to survive from one year to the next. For example, businesses that are planning to undertake long-term research projects should be able to calculate, with some degree of certainty, the cost of that research. Likewise, because construction projects have a relatively long lead-time, builders need to know whether the low-income housing tax credit will be available when an affordable housing project is placed in service sometime in the future. Furthermore, firms that are projecting long-term hiring costs would like to know whether or not they will be able to count on the targeted jobs tax credit being available.

To deal with these temporary tax provisions, once and for all, would fulfill at least four of the Tax Foundation's principles of taxation. First, there would be careful analysis to determine which provisions should be kept, and, if necessary, improved. Moreover, the need for retroactive changes to the tax law would be minimized. Finally, there would be some stability, and, thus, simplicity injected into the Internal Revenue Code.

Press Conference at Soviet Embassy Announces Moscow Business Conference

Soviet President Mikhail S. Gorbachev has invited the Tax Foundation and the Foundation for International Cooperation and Development to sponsor the Moscow Business Conference at the Kremlin, December 2-7, 1991. The event will also serve as the kickoff to a program in Soviet schools run by Junior Achievement.

Viktor Komplektov, the U.S.S.R.'s Ambassador to the United States, made the announcement on October 4 with James B. Hayes, chairman of Junior Achievement; and James C. Miller III, Co-Chairman of the Tax Foundation and former Director of the Office of Management and Budget under President Reagan. Miller and Arkady Volsky, a member of the four-man Committee on Economic Management formed after the failed coup, are co-chairing the Moscow Business Conference.

Miller called the conference, which will unite more than 1,500 Soviet and American business and government leaders, "the first major bilateral conference in the post communist era to discuss banking, finance, ruble convertibility, joint ventures, taxation reforms and property ownership by Soviets and foreign investors." ■

To attend the conference, call 202-863-7651.

Speaking at center: Viktor Komplektov, Ambassador from the USSR to the United States. Listening at left is James C. Miller III, Co-Chairman of the Tax Foundation and of the Moscow Business Conference. At right is the chairman of Junior Achievement and publisher of Fortune, *James B. Hayes.* ▶

THE
Moscow
BUSINESS
CONFERENCE
1991
TAX FOUNDATION
Junior Achievement

▲ *From left: Dan Witt, Executive Director, Tax Foundation; James C. Miller III, Co-Chairman of the Tax Foundation and of the Moscow Business Conference; and Viktor Komplektov, Ambassador from the USSR to the United States.*

Tax Features

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Tax Features

Tax Cut Fever Strikes Washington

With the persistent sluggishness of the economy, more and more legislators are becoming interested in tax cuts as a means for economic stimulus. For a time, last month, it looked as if a tax reduction were a sure thing; if not this year, then early next year. Then, all of a sudden, tax cut fever abated as quickly as it had struck, due primarily to the fears on Wall Street and in the bond markets that a tax cut simply would fuel an already out-of-control federal budget deficit. However, now that both tax-writing committee chairmen have introduced their tax bills, interest in tax cut legislation is again heating up.

Now that both tax-writing committee chairmen have introduced their tax bills, interest in tax cut legislation is again heating up.

House Ways and Means Committee Chairman Dan Rostenkowski (D-IL) recently introduced a middle-income tax relief package that has four major components (see table on page 2). The tax relief component of the package would, for a two-year period (1992 and 1993), provide a refundable tax credit equal to 20 percent of an employee's share of social security tax (10 percent in the case of a self-employed individual). The maximum tax credit would be $400 for taxpayers filing joint returns and $200 for single taxpayers. Because the tax credit would be refundable, taxpayers who do not have tax liabilities sufficient to fully offset the credit would receive direct payments from the Treasury. The price for this middle-income tax relief would be the addition of a fourth individual income tax bracket of 35 percent; a 10-percent surtax on tax attributable to taxable income in excess of $1 million, and a top individual alternative minimum tax rate of 25 percent. The new 35-percent rate bracket would begin at taxable incomes of $145,000 (joint return), $85,000 (single), and $125,000 (head of household).

Senate Finance Committee Chairman Lloyd Bentsen (D-TX) has taken a different approach

See Tax Cut Proposals on page 3

Tax Foundation

IN THIS ISSUE

Tax Cut Fever 1
"Front Burner" 1
Bentsen Interview 4
Gramm Interview 5
Foundation Message 7
Corporate Tax Compliance Seminar in San Francisco 8

FRONT BURNER

Competitiveness in the International Securities Markets

Sen. Max Baucus

Currently, the U.S. tax law contains barriers to investment by foreigners in U.S. mutual funds. If these barriers were removed, foreign investors would be encouraged to invest in the U.S. economy through U.S. mutual funds, vehicles whose structure precludes shareholders from gaining control of the companies in which the funds invest. Significantly, the removal of these barriers would result in new capital formation from the inflow of investment dollars into U.S. securities markets. This, in turn, could have the beneficial effect of reducing interest rates, increasing the pool of equity capital needed to expand existing American business, and promoting the creation of new business ventures.

Over 36 million Americans invest in U.S. mutual funds. Moreover, the popularity of mutual funds has exploded over the past decade in the emerging European Community of over 325 million people. While U.S. mutual funds are well-positioned to capture a significant share of this market, our tax laws have effectively precluded sales of this important U.S. financial product to foreign investors. The fact that foreign shareholders account for less than one half of one percent of U.S. fund shares hurts U.S. competitiveness and deprives the U.S. economy of valuable foreign capital.

That is why I have recently introduced the Investment Competitiveness Act of 1991 (S. 1748) to improve the international competitiveness of U.S. mutual funds. In general, my legislation would remove the tax barriers that hinder international sales of U.S. mutual funds by providing that a foreign investor generally

See Baucus on page 7

Senator Max Baucus, Democrat from Montana, is a member of the Senate Finance Committee and Chairman of its Subcommittee on International Trade.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Selected Tax Proposals — November 12, 1991*

Introduced by	Tax Changes ✦				
	Capital Gains	Tax Rate Reductions	Social Security	IRA	Tax Credit
Bentsen				All individuals eligible for fully deductible $2,000 IRA, indexed for inflation, with penalty-free withdrawals for first-time home purchase, higher education, and medical expenses. **–$12.5 billion**	$300 non-refundable tax credit for each child 18 and under. **–$60.0 billion**
Bradley					$350 refundable tax credit for each child 18 and under. Credit is indexed to inflation. **–$116.0 billion**
Dreier	Index capital assets to rate of inflation. **–$4.6 billion**	10% reduction in personal income tax rates across the board. New rate schedule 13.5, 25.2, 27.9%. **–$175.0 billion**		All individuals eligible for deductible $4,000 IRA, with the limit indexed for inflation, with penalty-free withdrawals for first-time home purchase, higher education, and medical expenses. **N/A**	
Gore/ Downey					Replace personal exemption with $800 refundable tax credit for each child up to age 18. **N/A**
Gramm/ Gingrich	Reduce capital gains tax rate using sliding scale exclusion for first three years (+$9.5 bil.) and index capital assets to inflation (–$4.6 bil.). **$4.9 billion**		Increase Social Security earnings limit by $1,000. **–$4.5 billion**	Non-deductible IRA contributions tax free at withdrawal (+$13.8 bil.), and penalty-free withdrawal of up to 25% of funds for home purchase, education, and medical expenses (–$2.2 bil.). **$11.6 billion**	$1,000 tax credit for first-time home buyers with income up to $31,000 (Phased out by $41,000). **–$4.0 billion**
Kasten/ Weber	Reduce capital gains rate to maximum of 15% (minimum 7.5%) and index capital assets to inflation, with no tax on sale of principal residence. **–$53.1 billion (a)**			Non-deductible IRA contributions tax free at withdrawal, penalty-free withdrawal for up to 25% of funds for home purchase, education, and medical expenses. **$13.8 billion**	$300 non-refundable tax credit for each child age 6–18, $1,000 non-refundable tax credit for each child age 6 and under. **–$100.0 billion**
Moynihan			Lower Social Security payroll tax rate to 5.2% over five years for employer/employee. **–$196.1 billion**		
Rostenkowski					Refundable income tax credit for 20% of Social Security and medicare payroll taxes paid by employees (individuals capped at $200, joint filers at $400). **–$45.8 billion**
Roth		Reduce individual income tax rates by 3 percentage points for lower brackets. New rate schedule:12, 25, 28, 31%. **–$106.3 billion**	Repeal earnings test on Social Security. **–$5.8 billion**	All individuals eligible for fully deductible $2,000 IRA, indexed for inflation, penalty-free withdrawals for first-time home purchase, higher education, and medical expenses. Includes rollover provision. **–$11.1 billion**	Incremental investment tax credit (10% of the increased investment). **–$28.6 billion**
Wallop/ DeLay	Reduce capital gains rate to maximum of 15% (minimum 7.5%) and index capital assets to inflation. **–$52.7 billion**		Lower Social Security payroll tax rate to 5.3% for employer/employee. Off budget = –264.2 bil., On budget = +$27.4 bil. **$27.4 billion**	Non-deductible IRA contributions tax-free at withdrawal, penalty-free withdrawal for up to 25% of funds for home purchase, education, and medical expenses. **$3.5 billion**	

* Due to space limitations, not all proposals are represented in this matrix. The Coats/Grassley/Wolf, Sasser, and Walker proposals are outlined in the text.
✦ Note that revenue estimates are based on five-year projections. Totals may not add due to rounding.
(a) Revenue estimates listed are static figures. Dynamic estimates differ: Capital Gains (+$63.7 billion), Neutral Cost Recovery System (+$37.5), Enterprise Zones (revenue neutral), for a net revenue gain of $11.8 billion.
Source: Tax Foundation. Compiled from corresponding bills and proposals.

Miscellaneous	Savings/Revenue Offset	Five-year Revenue Impact	Introduced by
	5% cut in defense **$72.5 billion**	Neutral	Bentsen
	$80.0 bil. in defense cuts: decrease military personnel, B-2, MX, Midgetman. $38.0 bil. in domestic program cuts: superconducting supercollider, space station, U.S. Postal Service subsidies. **$118.0 billion**	Neutral	Bradley
Index depreciation schedules to rate of inflation to reflect actual replacement costs of depreciable assets. **–$50.0 billion**	Limit total government spending to 4% annual increases from FY 93 to FY 98. **$305 billion**	Positive	Dreier
Expand earned income tax credit. **N/A**	Implement new personal income tax rate schedule for higher income earners. New rate schedule: 15, 28, 32, 35%. Impose11% surcharge on taxpayers with AGI over $250,000. Increase AMT rate to 29%. **N/A**	Neutral	Gore/ Downey
Enterprise zones (–$6.2 bil.), Permanent R&E credit (–$1.8 bil.). **–$8.0 billion**		Neutral	Gramm/ Gingrich
Neutral Cost Recovery System (–$58 bil.), passive activity loss relief to material participants in real estate (–$3.2 bil.), enterprise zones (–$1.8). **–$63.0 billion (a)**		–$202.3 billion (a)	Kasten/ Weber
	7% cut in defense (+$100 bil.). Cuts various domestic programs, e.g., space station (+$25 bil.). Expand taxable wage base for payroll tax to $80,000. Assumes increased income tax collections (+$39.6 bil.) Cuts in CIA and related intelligence agencies (+$30.0 bil.) **$194.6 billion**	Neutral	Moynihan
	Adds fourth income tax bracket with a 35% rate attributable to individuals with taxable income over $85,000 ($145,000 for joint filers). Imposes 10% surtax on taxable income over $1 million. Increases AMT to 25%. **$45.8 billion**	Neutral	Rostenkowski
Repeal boat user fee and extend unemployment insurance benefits. **–$3.4 billion**	9.5% cut in defense (+$130.2 bil.). Domestic program cuts, i.e., reduce farm credits, limit federal civilian personnel hiring, etc. (+$30.8 bil.) Intelligence Agency cuts (+$2.5 bil.) **$163.5 billion**	$8.3 billion	Roth
Adopt neutral cost recovery system that adjusts current depreciation schedules for inflation. **–$63.8 billion**		–$85.6 billion	Wallop/ DeLay

Tax Cut Proposals from page 1

in his recently introduced tax bill. Rather than reducing taxes for middle-income taxpayers by raising taxes on upper-income taxpayers, Senator Bentsen proposes a tax credit for dependent children, as well as improvements to individual retirement accounts (IRAs).

Under the Bentsen plan, families would be entitled to non-refundable tax credits for each child under the age of 18. Moreover, the ability of all individuals to make fully deductible contributions of up to $2,000 annually to IRAs would be restored, and the $2,000 contribution limit would be indexed for inflation.

Under Senator Bentsen's IRA proposal, which has been co-sponsored by Senator Roth (R-DE), taxpayers would have the option of foregoing immediate deductions for IRA contributions and instead, not paying taxes when money is withdrawn from an IRA. In addition, individuals (or their parents or grandparents on their behalf) could make penalty-free IRA withdrawals to purchase a first home, students (or their parents or grandparents on their behalf) could make penalty-free withdrawals to pay for college tuition, and individuals who incur medical expenses for themselves or for their dependents which exceed 7.5 percent of their adjusted gross income, could make penalty-free withdrawals to help cover those costs.

These are by no means the only tax cut proposals making the rounds on Capitol Hill. At last count, there were at least 11 other comprehensive tax reduction proposals being circulated. These include proposals by Senator Bradley (D-NJ), the "Family Tax Relief Act of 1991," Senator Gore (D-TN) and Representative Downey (D-NY), the "Working Family Tax Relief Act," Senator Gramm (R-TX) and Representative Gingrich (R-GA), "The Economic Growth Act," Senator Kasten (R-WI) and Representative Weber (R-MN), the "Economic Growth and Family Tax Freedom Act of 1991," Senator Moynihan (D-NY), the "Social Security Tax Cut Act of 1991," Senator Roth (R-DE), the "Jog America Plan," Senator Wallop (R-WY) and Representative DeLay (R-TX), the "Economic Growth and Job Creation Act," Representative Dreier (R-CA), the "Tax Relief and Economic Growth Act," Representative Walker (R-PA), the "Economic Growth

See Tax Cut Proposals on page 6

Bentsen Seeks Expanded IRAs and Tax Credit for Children

Senate Finance Chairman Is Open to Capital Gains Tax Reduction

On October 28, 1991, Tax Foundation economist Paul Merski interviewed Senator Lloyd Bentsen (D-TX), Chairman of the Senate Finance Committee, on his tax-relief proposal to expand the tax benefits of Individual Retirement Accounts and provide a tax credit for dependent children.

Q Recent Tax Foundation analysis of the typical American family showed it to be $362 dollars poorer in 1991 due to federal taxes and inflation. How will the Bentsen tax-relief plan help to reverse this decline in the family's purchasing power?

A The legislation I am proposing would give these families a $300 tax credit for each child. For a family of four making $35,000 a year, that will reduce their federal income tax bill by $600 or 25 percent. This will put real dollars in people's pockets that they wouldn't otherwise have to spend or to save.

Q Just last year, you participated in putting into place a five-year budget deal that called for $164 billion in additional revenues and set specific spending caps. With the lackluster performance of the economy, is it time to look beyond the budget agreement in order to reduce the tax burden and stimulate economic growth?

A There is no question that the economy is dead in the water. Economists tell us that putting money in the pockets of working Americans is an effective way to spur economic growth, and increasing this country's lagging savings rate is an effective way to sustain that growth. My legislation is aimed at both those results, but let me add that my proposal does not increase the deficit. The $72.5 billion tax cut that I'm proposing would be paid for by a 5 percent cut in defense spending over the next five years. My proposal would require amending the budget act to allow defense funds to offset tax cuts, but it's not a budget-buster.

My proposal would give our economy a jump start, even though it doesn't add to the deficit, because of the way I've timed it. The tax cuts would go into effect January 1, 1992, and from that moment, people would have less taxes withheld from their paychecks. The defense cuts wouldn't begin until fiscal 1993, and those cuts would be phased in gradually, over a five-year period. This adds up to a $15 billion stimulus in fiscal 1992 alone.

Q As you have often pointed out, the U.S. savings rate lags behind that of every other industrialized nation. How does your tax-relief plan address the critical need to increase family savings?

A I'm proposing to bring back the IRA for every working American. Today the fully deductible IRA is available only to people not covered by a pension plan *and* who have individual income under $25,000 or family income under $40,000. That excludes a lot of people and, as a result, deters saving. Between 1981 and 1986, before the current limits on IRAs were imposed, household savings rates were a whopping forty percent above the savings rates we saw after eligibility was curtailed.

I am also proposing to improve the IRA. For example, I would expand it to allow penalty-free withdrawals to buy that first home, send kids to college and combat financially devastating medical expenses. I also propose to give people the option of either getting an immediate deduction when money is deposited or forgoing the deduction and, instead, not paying tax on the money when it is withdrawn.

Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, tells Paul Merski about his new tax relief proposal.

Q How would you respond to the often-heard claim that Individual Retirement Accounts simply cause a shift in existing savings of upper-income individuals and generate little new savings from middle-income families?

A Recent studies show that the IRA does generate new savings. And if we go further — with the expanded Bentsen IRA — we should see an even greater impact on savings. I think the IRA works primarily because of the attractiveness of the reduction in income tax and the advertising by banks and investment houses to promote the IRA. Around April 15th, people decide that they would rather write a check to their IRA than to the IRS.

If people were simply shifting existing savings into IRAs, they'd make the contribution at the beginning of the year to maximize the tax advantages. But they don't — most IRA contributions are made at the last possible moment. If they were shifting savings, they'd make the maximum permitted contribution. But they don't do that either — only one third of IRA contributors put in the maximum amount.

Q Your $72.5 billion tax-relief plan will be paid for by a five percent cut in defense spending over the next five years. The defense budget is already slated to be cut 20 percent in real terms during this period. Could additional savings and associated tax cuts be realized from the domestic spending side?

A The collapse of the Soviet Union, the President's declaration that the Cold War is over and his decision to cut nuclear arms are all

See Bentsen on page 6

Gramm Proposes Lower Capital Gains Tax, Expanded IRAs and Permanent R&E Credit to Boost Economic Growth

On November 7, 1991, Paul Merski interviewed Senator Phil Gramm (R-TX), about his Economic Growth Act. This tax-relief proposal would lower the capital gains tax rate, expand the tax benefits of Individual Retirement Accounts and provide a permanent tax credit for research and experimentation.

Q The Tax Foundation has calculated the tax burden on the average American to be at an all time high this year, yet we face record federal deficits and dismal economic growth. Briefly, what is your Economic Growth Act and how will it jump-start the economy?

A The Economic Growth Act that I've proposed is designed to provide needed job creation, savings, homeownership, and work incentives without increasing federal spending. The best way to help the average American at this point is to stimulate the economy, shorten the recession, and insure that the recovery which follows is stronger. For investment and job creation, I have proposed a capital gains rate reduction, creation of enterprise zones and a permanent research and experimentation (R&E) tax credit. Savings would be stimulated by encouraging individual retirement account (IRA) investment, and homeownership would be fostered by the proposal's first-time homebuyer's tax credit for families with incomes under $41,000.

Q Unlike many of the other major tax relief proposals currently being promoted, your plan does not outline any savings from the outlay side of the ledger. Could additional tax relief and deficit reduction be realized by examining spending reductions as well?

A Well, the second part of my plan - the Peace Dividend Investment Act - outlines what to do with any savings that accrue in defense in the future. Many Democrats have a clear agenda for defense savings; they want to spend it. My proposal suggests we put into law a mechanism that assures that half of the defense savings goes to deficit reduction and the other half is returned to working Americans in the form of increased personal exemptions. This will allow families to invest in their own economic futures. Many Democrats will argue that they want more government investment in education, health, nutrition, etc. I argue that we would be far better off to let families invest in those things.

Q We have witnessed real defense spending reductions in the past where the deficit and the tax burden are still allowed to increase sharply. How will your plan attempt to change this trend?

A I am proposing to insure that when defense spending is reduced in the future, rather than allowing government to spend that money, that money is given back to working families by raising the personal exemption. Now, some may say that this is an overstatement, but I don't think there is any living person who has worked harder to reduce federal spending more than I have. Do I think under the current circumstances, with the budget agreement in effect, that we will have a dramatic reduction in domestic spending? No. I think the realistic battleground is going to be trying to assure that any peace dividend goes back to working Americans rather than letting government spend it. If we do that, the government will actually become smaller relative to the private sector of the economy. If we can't do that, we will end up being the only country in the world that invests our peace dividend in government rather than in the private sector. Ironically, it was our private sector investment and expansion which made us a success as an economic power rather than making government the economic decision-maker as in the Soviet Union.

Senator Phil Gramm (R-TX) explains his Economic Growth Act to Tax Foundation economist Paul G. Merski.

Q Does your economic growth plan conflict with last year's five-year budget agreement?

A An important point I want to make is that we are operating under a budget constraint. This means that any proposal that is not deficit neutral must have an offset. To me this does not mean we have a mandate for new taxes. Additionally, anything we do that violates the budget agreement on the revenue side opens it up for the Democrats to violate the budget agreement on the spending side — and you're looking at the potential of tens of billions of dollars in new domestic spending if that occurs. Therefore, in order for a proposal to be realistic - that is, (A): to have any chance of being passed, and (B): for it not to open the flood gates for massive government spending in the name of stimulating the economy - it must be revenue neutral. The advantage of my proposal is that it has the ingredients necessary to stimulate the economy without breaking the budget agreement, without increasing the deficit, and it does not increase any American's taxes.

Q As you have pointed out, the capital gains rate reduction is a major component of your economic growth plan. How do you respond to the claims that reducing the capital gains tax unfairly benefits upper-income groups and is a revenue loser?

A The Treasury model, which is basically a static model, scores the capital gains rate reduction as

See Gramm on page 6

Bentsen from page 4

signals that we can expect more savings in defense spending in the years ahead than were contemplated in the budget summit a year ago. Even the additional 5 percent defense cut that I propose would leave the defense budget at $1,387 trillion over the next five years. That's 94 percent of what we spent over the past five years. I believe middle-income Americans deserve a slice of this peace dividend.

Q As you are aware, there is a growing number of tax cut proposals on both sides of the political aisle claiming to be the correct means to stimulate economic growth. Will a viable tax-relief plan need to be a hybrid of these proposals?

A Every bill that we pass is a product of compromise. Everybody has to accept a little give and take. But a tax cut for middle-income taxpayers is a high priority for me.

If you're really asking whether a bill will include a capital gains tax cut, I have always been open to the notion of providing some sort of tax reduction on capital gains. In fact, last year Democratic negotiators during the budget summit were prepared to accept a reduction in the capital gains rate and offered some specific proposals. But these offers were rejected because we insisted that the cut be paid for in a way that made the overall proposal fair. By that, I mean that the people who stood to benefit most — high-income taxpayers — should have also borne the burden of paying for the proposal. The Administration rejected this fairness principle. We are waiting to see whether the Administration wants to talk capital gains this time around.

Q What reaction has your tax-relief plan received from your colleagues here on Capitol Hill and from middle-income families around the nation?

A I've been very pleased with the reaction so far. Although some of my colleagues have their own ideas about the type of relief they favor, there seems to be a wide-ranging recognition that we need to help the economy and middle-income families. The mail is starting to pour in from those families all around the country, and they're agreeing that this is the least we need to do. ■

Gramm from page 5

something that will increase revenues. We have never cut the capital gains tax rate in the post-war period where revenues have not gone up. In the midst of a recession, every outside economic firm that I am aware of estimates that reducing the capital gains tax rate will stimulate the economy and generate more revenues because of increased transactions. In terms of the so called fairness issue, I plan to create wealth, not redistribute it. The economics of class warfare has been rejected now in Eastern Europe, the Soviet Union, and everywhere else in the world except for a small clique around Fidel Castro and at the National Democratic Party. Unfortunately, the whole capital gains debate is being poisoned for political reasons and the American people are suffering as a result.

Q Your economic growth plan also calls for the permanent extension of the R&E tax credit. How do you respond to some of your colleagues who feel we can no longer afford any revenue costs of such tax expenditures?

A I say to them that if we are going to continue to promote the growth of new technology, if we are going to maintain cutting-edge advantages in technology, advantages that foster our economic growth, we must do a better job of encouraging research and development. We have clearly been losing ground in many high-tech areas where we once held a solid competitive advantage. From a national point of view, the idea that we ought to end encouraging research and development simply to spend even more money for domestic programs is suicidal.

Q With the numerous tax relief proposals now on the table, do you think we will need some type of grand compromise among these plans to get any tax relief this year or next?

A You always have to have compromise when you are talking about the legislative process. But one thing I do not feel should be part of any compromise is raising anyone's taxes. Many lawmakers would like to see Rostenkowski's form of soak-the-rich tax policy. Once they start down that road to "tax the millionaires," as they have on many occasions in the past, the poorest and most hard working among us best take cover. ■

Tax Cut Proposals from page 3

Act of 1991;" and Senator Grassley (R-IA), Senator Coats (R-IN) and Representative Wolf (R-VA), "The Tax Fairness for Families Act of 1991." In addition to these proposals, Senator Sasser (D-TN), Chairman of the Senate Budget Committee, has proposed reducing defense spending by $70-80 billion over the next five years, and using that amount to provide middle-income tax relief.

Five of the proposals (Dreier, Gramm/Gingrich, Kasten/Weber, Wallop/DeLay, and Walker) would attempt to promote economic growth by reducing taxes on long-term capital gains. Six proposals, in addition to Senator Bentsen's, would try to stimulate national savings by improving IRAs (Dreier, Gramm/Gingrich, Kasten/Weber, Roth, Wallop/Delay, and Walker).

Quick action could come next year, particularly if the current economic doldrums persist.

Although many of these proposals share common features (*e.g.*, capital gains tax reductions, expanded IRAs, middle-income tax cuts, etc.), some contain provisions that are more unique. For example tax credits for first time home buyers would be provided in the Gramm/Gingrich and Walker proposals. Moreover, Senator Roth proposes an incremental investment tax credit, and Representative Walker proposes a permanent research and experimentation tax credit. Furthermore, the Kasten/Weber plan would provide passive activity loss relief to real estate developers and real estate professionals.

So far, the White House has not weighed in with a tax reduction plan of its own. However, according to recent remarks by Budget Director Richard Darman, The White House is leaning toward a temporary package (one year) of capital gains tax reduction, expanded IRAs, tax incentives for home buyers, and middle-income tax relief.

The time remaining to Congress this year makes it unlikely that any tax-relief or pro-growth package can be enacted in 1991. However, quick action could come next year, particularly if the current economic doldrums persist. ■

Baucus from page 1

would receive the same U.S. tax treatment investing in a U.S. mutual fund that the investor already receives by investing directly or through a foreign mutual fund.

The two specific aspects of U.S. tax law that make U.S. mutual funds an unattractive investment for foreign investors are the withholding and distribution requirements. The following examples explain why these are deterrents to foreign investment.

First, take the case of a foreign investor who wants to invest in U.S. debt obligations that pay interest or U.S. securities that may be sold for short-term capital gain. If the foreign investor makes either of these investments directly, or through a foreign mutual fund, he or she generally is not subject to U.S. withholding tax. However, if the foreign investor buys either of these instruments through a U.S. mutual fund, the withholding tax applies. All too often, the result is that foreign investors simply will not buy shares in a U.S. mutual fund. My legislation would correct this anomaly, and treat investments in U.S. mutual funds similar to those in foreign mutual funds, by not converting distributions of interest and short-term capital gains into dividends for U.S. withholding tax purposes.

While U.S. mutual funds are well-positioned to capture a significant share of this market, our tax laws have effectively precluded sales of this important U.S. financial product to foreign investors. The fact that foreign shareholders account for less than one half of one percent of U.S. fund shares hurts U.S. competitiveness and deprives the U.S. economy of valuable foreign capital.

The second example of the deterrent effect of current U.S. law involves the foreign investor who wants to accumulate investment income in the mutual fund rather than take current income distributions. A foreign investor who owns shares in a foreign mutual fund typically pays tax in his or her home country only when cash is received or the fund shares are sold. In contrast, if the same investor owns shares in a U.S. fund, the U.S. tax law distribution requirement results in home-country tax even if the income is reinvested in the fund and allowed to accumulate.

My legislation would effectively harmonize U.S. tax rules with those of other countries by creating an International Regulated Investment Company (IRIC). This would be a U.S. corporation that could invest in the shares of a single mutual fund. Only foreign investors could own stock in an IRIC. The IRIC would not be required to distribute its income or capital gain annually. Instead, it would be required to pay a tax annually at the entity level equal to the tax that would have applied to the IRIC's shareholders had they invested directly in the mutual fund shares held by the IRIC.

Because current U.S. tax law has effectively precluded foreign investment in U.S. mutual funds, my legislation will have negligible, if any, revenue effect. I believe that my legislation would encourage long-term investment by foreign investors in U.S. mutual funds, and would improve the ability of U.S. industry to compete in a burgeoning global market. ■

FOUNDATION MESSAGE

Maybe Not in Time for Christmas But Tax Cut Would Be Welcome Relief

Dan Witt
Executive Director

Oh what a difference a year makes! Tax-relief bills are tumbling down from Capitol Hill like confetti, and although the President has handled them with kid gloves so far, we have devoted this issue of *Tax Features* to analyzing the various proposals.

But in late 1990, legislators were not talking about *cutting* taxes to relieve the burden on taxpayers; they were *raising* taxes in a doomed attempt to relieve the government of its embarrassingly high deficit. Despite the fact that true deficit reduction can only come from lower spending, Democratic leaders from Congress and a Republican President did eventually agree on the second highest tax increase in history. And just seven months later, most taxpayers saw their state legislators pass record-high tax increases.

Between the federal and state tax hikes, the American taxpayer is facing about $52 billion in new taxes in fiscal year 1992, so there's no doubt that it's time for some relief. How much relief we get depends not only on which proposal, or combination of proposals, is adopted, if any. It also depends on how the economy would react.

All the proposals suggest that they would jump start the economy — five of them have the phrase 'economic growth' in their titles. We're already in the middle of a phantom recovery, and with so much talk about a double-dip recession, we certainly need economic growth.

How would the average American family fare under these tax-relief proposals? Four of the bills have the word 'family' in their titles, and most of them are explicitly targeted to put extra disposable income in the hands of middle-income people. This of course raises the fairness flag — a banner under which many tax increases have ridden through Congress. Now the same banner will apparently serve for tax cuts. So what does 'fairness' really mean?

The gist of the fairness issue is how the tax code affects the distribution of income, but for my money, 'fairness' means lower taxes for all Americans, not just for the rich, the poor, or the middle class.

Corporate Tax Compliance Seminar Schedule

8:30 a.m.	***Registration***
9:00	***Welcome:*** **W. Ronald Bunn** Director of Corporate Development, Tax Foundation ***Session I — Tax Compliance Costs: Industry and Government Perspectives*** ***Moderator:*** **Floyd L. Williams, III** Chief Tax Counsel, Tax Foundation ***Industry Panel:*** **Martin Sooper** Director of Taxes, Pacific Telesis Group **Peter Campagna** Tax Compliance Manager, Intel Corp. **J.P. LaCasse** Director of Taxes, American President Cos. **Richard C. Lam** Manager – Tax Audit, Chevron Corporation **Patricia M. Kaltz** Director of Taxes & Tax Counsel, Nellcor, Inc. ***Government Panel:*** **John Monaco** Executive Director, Office of Coordinated Examination Programs, IRS **Scott McLeod** Legislation Counsel, Joint Committee on Taxation **Steve Glaze** Tax Legislative Assistant to Senator David Pryor (D-AR)
10:15	***Coffee Break***
11:30	***Session II — Getting a Fix on the Cost of Compliance*** **Dr. Joel Slemrod** Director, Office of Tax Policy Research, University of Michigan
12:30 – 1:30 p.m.	**Luncheon** ***Speaker:* Robert P. Wayman** Senior Vice President and Chief Financial Officer, Hewlett-Packard

- **Call the hotel directly for room reservations at 415/589-0770 or 1-800-445-8667. Fax 415/589-4696.**
- **For seminar information, call: Dee Dee Hannum, 202/863-5454. Fax 202/488-8282.**
- **Send $125 check, made out to Tax Foundation Compliance Seminar, to Tax Foundation, 470 L'Enfant Plaza, SW, Suite 7400, Washington, DC 20024.**

Registration Form

Corporate Compliance Seminar
December 4, 1991, in San Francisco

Name ____________________

Company ____________________

Address ____________________

City ____________ State ________ ZIP ____________

Telephone ____________ Fax ____________

Foundation Seminar Examines Corporate Tax Compliance

In conjunction with the San Francisco and Santa Clara Valley chapters of Tax Executives Institute, the Tax Foundation will present a half-day seminar on corporate tax compliance at the San Francisco Airport Hilton Hotel on Wednesday, December 4, 1991, from 8:30 a.m. to 1:30 p.m. The Foundation has undertaken a major project on the subject; its centerpiece will be a study by Professor Joel Slemrod, director of the University of Michigan's Office of Tax Policy Research. Professor Slemrod will be gathering information from the seminar participants as he studies the relevant problems. ■

Tax Features

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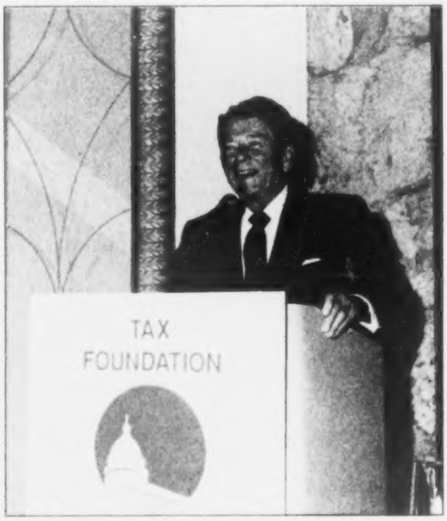
Tax Features

Presidential Visit Highlights 43rd Annual Conference

President Ronald Reagan dropped in unannounced at the Tax Foundation's 43rd annual conference in New York City on November 20. Tax Foundation Co-Chairman James C. Miller III, President Reagan's Director of the Office of Management and Budget, introduced "the man who has had the most impact on tax policy in the past several decades, my former boss, the 40th President of the United States, Ronald Reagan."



President Ronald Reagan made a surprise appearance at the Tax Foundation's annual conference. He urged the crowd, especially the many young people in attendance, to participate in our democratic system, to "twist the arms" of our elected representatives when they don't respond to the wishes of the people.

The audience of 225, including 100 students in attendance as part of the Tax Foundation's College Classroom Project, kept up sustained applause, but the President eventually quieted them and warmed to the subject of taxes. "When we had our big tax cut in the beginning of my first administration, revenues jumped and the economy jumped. For the next eight years, this country had the biggest economic increase in its history."

Part of his plea for lower rates was an endorsement of President Bush's proposal to lower the capital gains tax rate. President Reagan urged the assembly to dismiss congressional fears that the government would collect less

See Conference on page 3

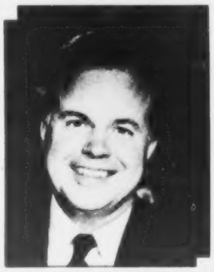
Tax Foundation

IN THIS ISSUE

Annual Conference 1
"Front Burner" 1
Tax Cuts and the American Family 3
Foundation Message 7
Annual Dinner 8

FRONT BURNER

Long-Term Growth Should Be Tax Policy's Top Priority



Sen. Robert Kasten

The U.S. economy is stalled. The result of massive tax hikes and increased regulation, the recession has cost over 1.5 million Americans their jobs. Implementing an economic recovery package that will get the economy moving again should be the top priority of Congress and the Administration.

An economic recovery package should do more than provide a temporary stimulus to the economy. It should also put into place tax policies that will sustain long-term economic growth. I have joined with Representative Vin Weber of Minnesota in introducing the "Economic Growth and Family Tax Freedom Act of 1991" (S. 1920, H.R. 3744). This package offers the best plan to revive the stalled economy, sustain long term growth, and reduce the heavy tax burden on middle class families.

America's prosperity is threatened by slow economic growth. Our post World War II growth path is 3 percent real growth in GNP per year. When we fall below that, it means lost jobs, lost output and lost family income. The economy has been growing at well below that level for the last two years, and even if the economy turns around and grows at the Office of Management and Budget's projected 2.5 percent per year, it will mean 9 million fewer jobs by 1996, relative to the normal post-war growth path. Clearly, this "growth gap" must be eliminated.

The Kasten-Weber proposal is designed to eliminate the growth gap with a six point plan that includes tax credits for working families with children, a reduction in the capital gains tax, a speed-up of depreciation for business

See Kasten on page 2

Senator Robert W. Kasten, Wisconsin Republican, is Chairman of the Senate GOP Task Force on Economic Growth and Job Creation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Kasten from page 1

equipment and machinery, expanded IRAs, reform in the tax treatment of real estate, and enterprise zones.

Our proposal reduces the heavy tax burden on families by providing a $300 tax credit for each child age 6-18, and a $1,000 tax credit for each child under age 6. This credit is available only for working families, and can be used only to the extent of income tax and payroll tax liability.

Even if the economy turns around and grows at OMB's projected 2.5 percent per year, it will mean 9 million fewer jobs by 1996, relative to the normal post war growth path.

The middle-class family has been squeezed particularly hard by the increasing burden of taxes. The Tax Foundation reports that the typical taxpayer now works until May 8 of each year just to make enough to pay its total tax bill. The declining value of the dependent exemption is largely responsible for the heavy tax burden on families. If the dependent exemption shielded from taxation the same proportion of annual income in 1991 as it did in 1948, a family today would be able to exempt nearly $8,000 per child instead of the current $2,150. Our tax credit is designed to address this dramatic decline in the value of the dependent exemption.

Our proposal also slashes the capital gains tax from 28 percent to 15 percent (7.5 percent for those in the lower tax bracket). This is coupled with indexing to protect savers and investors from inflationary gains. Most other growth packages introduced in Congress either contain no capital gains tax cut or watered-down versions of the proposal that will do little to stimulate the level of investment necessary to create new ventures and new jobs. By contrast, economist Allen Sinai estimates that a 15 percent rate will create up to 2.5 million new jobs over 5 years. It will also bring the U.S. into line with the other leading capitalist economies, many of which have no tax at all on capital gains.

Moreover, this proposal reforms the current system of tax depreciation. In order for American industry to remain competitive, the tax treatment of equipment and machinery purchases needs improvement. When machinery is purchased, its cost cannot be written off immediately, but must be deducted over a number of years. The value of this deduction is eroded by inflation and the time value of money. Our proposal addresses this erosion by indexing depreciation schedules so that the value of each year's deduction keeps pace with inflation.

In addition, our package eliminates the disincentive for capital investment that results from the Alternative Minimum Tax (AMT) treatment of depreciation. Presently, any depreciation in excess of straight line depreciation is included as an adjustment under the AMT. This actually punishes capital intensive companies. At a time when our international competitors are doing everything possible to encourage capital investment, the U.S. is doing the opposite. We eliminate this disastrous policy by completely phasing out the corporate AMT depreciation adjustment by the year 2000.

One of the major reasons the economy is performing poorly is the depressed value of real estate. The Tax Reform Act of 1986 contributed to this decline in values by increasing the capital gains tax and imposing unfair passive loss restrictions on real estate. Investment in rental real estate was singled out during Tax Reform and defined as "passive" investment regardless of whether a taxpayer materially participates in the activity. Generally, no losses from this passive activity can be used to offset other income.

Our legislation changes this by providing equality in treatment under the passive loss rules. That is, the taxpayer would be allowed to establish that he or she materially participates in the rental activity. If so, losses from the rental real estate activity would be deductible without restriction. By increasing the value of real estate, this reform will have the beneficial side effect of reducing the cost of the S&L bailout.

The Kasten-Weber package encourages long-term saving by establishing IRA-Plus accounts. This will permit individuals to make non-deductible contributions to IRAs where the interest accumulates and compounds; then it is distributed tax free. The proposal allows for the use of up to 25 percent of the account for education, the down payment on first-time home purchases, and certain medical expenses.

Finally, the legislation creates enterprise zones which target business investment and job creation in economically depressed urban and rural areas. Enterprise zones offer special tax incentives to companies that locate and create jobs in economically depressed areas. The zone tax incentives include an employee tax credit, elimination of the capital gains tax on zone investments and real property, and stock expensing. Enterprise zones have been successfully implemented in dozens of states. The addition of federal tax incentives would provide a major boost to these programs.

How will we pay for these tax incentives? The big reason for today's record budget deficit is the decline in tax revenues due to recession. Get the economy moving again with growth incentives, and tax revenues will rise. Using the Congressional Budget Office's "rules of thumb," if our tax cut plan raises the rate of growth just one percentage point per year over today's forecast, the cumulative deficit reduction would add up to $258 billion by 1996 — more than enough to finance the static cost of these tax cuts. Adding Sen. Lloyd Bentsen's $70 billion "peace dividend" from a lower U.S. defense profile would put the budget deficit on a permanent downward glidepath.

An economic recovery package . . . should also put into place tax policies that will sustain long-term economic growth.

Many "growth" packages have been introduced in Congress in the last several months. Unfortunately, few of these provide for the type of comprehensive tax reform that is necessary to sustain long-term economic growth. Several tax plans are not tax cuts at all, but merely offset tax credits with higher tax brackets. These plans attempt to redistribute wealth, not create it. Others simply do not contain enough tax reduction to make a significant difference to the average taxpayer. The Kasten-Weber proposal provides both substantial tax relief and dramatic growth incentives that are necessary to rebuild the economy. ■

Conference from page 1

revenue. "You are going to have an increase in economic growth and an increase in revenues."

Despite criticizing Congress for being "dead-set against things that would reduce the burden of taxation," President Reagan put part of the blame on citizens who don't participate in government. " 'We The People' is what our whole Constitution is about," he said, adding, "Each of us has a responsibility to let those representatives of ours in government know when we think they are doing things that are detrimental to the society and to our way of life."

Tax Fairness — Reality and Rhetoric

Though unplanned, the appearance by President Reagan dovetailed nicely with the first theme of the conference, "tax fairness." It was during his first term that he signed into law the most dramatic tax cut in the last 25 years, the Economic Recovery Tax Act of 1981. Then during his second term, the Tax Reform Act of 1986 became law, thoroughly revamping the tax code and drastically reducing marginal tax rates. These two pieces of legislation are the hallmarks of the Reagan era's tax legislative legacy and are common reference points in current discussions of whether tax policy is "unfair."

President Ronald Reagan enjoys a laugh with his former OMB Director, James C. Miller III, who is now co-chairman of the Tax Foundation.

Moderator Floyd Williams, chief tax counsel for the Tax Foundation, laid the groundwork for the debate, pointing out that the total tax burden as a percentage of national income is higher than ever, 35.1 percent, and that since 1980, the

See Conference on page 6

Foundation Shows Impact of New Tax-Relief Proposals on Typical American Family

The prolonged economic slowdown has prompted federal legislators to propose numerous tax-relief and economic growth measures. In response, the Foundation has produced a summary of the major proposals, titled *Fiscal Policy Update: Summary of Major Federal Tax Relief and Economic Growth Proposals*, which has been well received on Capitol Hill and in the media.

The report includes a summary matrix and brief discussion of each proposal's tax-relief and economic growth provisions, as well as its potential revenue impact. The table below provides a snapshot of how the bills would affect two typical American families in the first year after enactment. ■

1991 Major Federal Tax Relief Proposals

Example of Family Impact (a)

Proposal	Family Income	Income Tax	Social Security Tax	Total Tax	Net Savings
Current	$53,265 (b)	$6,493	$4,075	$10,568	-
Law	$30,000 (c)	$2,359	$2,295	$4,654	-
Bentsen	53,265	5,333	4,075	9,408	1,160
	30,000	1,459	2,295	3,754	900
Bradley	53,265	5,793	4,075	9,868	700
	30,000	1,659	2,295	3,954	700
Coats/Grassley/Wolf	53,265	5,397	4,075	9,472	1,096
	30,000	1,454	2,295	3,749	905
Dreier	53,265	5,346	4,075	9,421	1,147
	30,000	1,850	2,295	4,145	509
Gore/Downey	53,265	6,097	4,075	10,172	396
	30,000	1,404	2,295	3,699	955
Gramm/Gingrich	53,265	6,493	4,075	10,568	(d)
	30,000	2,359	2,295	4,654	(d)
Kasten/Weber	53,265	5,193	4,075	9,268	1,300
	30,000	1,059	2,295	3,354	1,300
Moynihan (e)	53,265	6,493	3,808	10,301	267
	30,000	2,359	2,145	4,504	150
Packwood	53,265	5,844	4,075	9,919	649
	30,000	2,123	2,295	4,418	236
Rostenkowski	53,265	6,093	4,075	10,168	400
	30,000	1,959	2,295	4,254	400
Roth	53,265	4,821	4,075	8,896	1,672
	30,000	1,644	2,295	3,939	715
Schulze	53,265	5,737	3,542	9,279	1,289
	30,000	1,954	1,995	3,949	705
Walker (f)	53,265	4,868	4,075	8,943	1,625
	30,000	1,766	2,295	4,061	593
Wallop/DeLay	53,265	6,493	3,595	10,088	480
	30,000	2,359	2,025	4,384	270

(a) First-year impact of direct changes in the personal income tax, employee Social Security tax, personal exemption, personal tax credits, and deductible IRA investments. (Excludes capital gains tax changes.)

(b) Estimated median family with two full-time workers. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.

(c) Estimated two-earner income for married couple household. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.

(d) Plan allows tax-free withdrawal of IRA and $1,000 tax credit for first time home-buyer not examined in this example.

(e) Additional future reductions in the payroll tax rate are scheduled.

(f) Also allows $1,000 tax credit for first time home-buyer not examined in this example.

Source: Tax Foundation.

Senator Max Baucus

Tax Cuts Yes — But For Investment in America

Let's imagine for a moment that in 1980 a Fortune 500 company had planned to reduce spending on new plant and equipment by 50 percent, postpone half of its research and development projects, cancel employee training programs, cut the employee health program, and defer maintenance on company buildings.

Where do you think that company would be today, 11 years later? Yet since 1980, the share of the nation's economy devoted to investments, education and training, children's programs, infrastructure and civilian R&D has dropped 40 percent. Our country can't continue down that road any more than a company could and expect to remain in business.

It is a time of uncertainty — the economy is flat, or it is falling. We just witnessed the credit card interest rate cap on and off again. Wall Street and Washington are blaming each other. Corporate America is very critical of the Congress and of the President. The voters are blaming everyone, and the President seems curiously disengaged.

This turmoil is illustrated by the current tax policy debate. Until recently, the 102nd Congress was expected to be very quiet in terms of tax policy. We were going to reauthorize expiring provisions and perhaps simplify some complex parts of the Code, but that was about it. Lobbyists were wondering how they were going to meet their expenses.

Suddenly, everything has changed. In the past few weeks, we have seen the tax scene explode with debate over various tax proposals. They are popping up like wind-swept wildfires: tax cuts for the middle class, all kinds of them; capital gains; IRAs; combinations of all three cutting in different economic and ideological directions.

Clearly, we need to take some short-term measures to restore economic growth, and tax cuts designed to accomplish this should be concentrated on middle-class working families. But there is real danger that competition for political advantage, especially in an election year, could yield a result that merely sows the seeds of greater problems down the road. Lurching through a series of short-term measures cannot substitute for a strategic vision to improve our economic competitiveness.

We can begin by taking advantage of the blossoming democracies and the free enterprises in Europe and the Soviet Union. We have achieved a true victory in the cold war, and with this victory comes a reward. Some call it a peace dividend. I think a better term would be an investment-in-America dividend.

How can we use it to our advantage? Let me suggest three priorities: deficit reduction, investment in America's future, and rewarding those who fought and won the cold war.

Our massive debt has done such damage to the economy that the first claim on any dividend must be deficit reduction. The growing mountain of debt has sapped savings and investment. We could do much to alleviate this, but without the President's help, the best we are likely to achieve is piecemeal progress. Nevertheless, something is better than nothing.

Second, a portion of this dividend should be used to prepare us for the next round of competition, the international economic struggle. We need to focus on investments that will increase our competitive edge. But remember, the words 'investment' and 'tax incentive' are not synonymous. Just because something reduces corporate taxes does not necessarily make it good tax policy.

There certainly are appropriate tax incentives. A permanent R&D tax credit is long overdue; IRAs to increase our long-term savings rate; and yes, a capital gains incentive to encourage investments in new and innovative companies. We must recognize that investment is not just tax credits — it involves some spending programs too, such as education and job training. Our children must be better prepared for their first job, and current workers need the security that comes with the wherewithal to adapt to changing employment opportunities and needs.

It means making investments in infrastructure — roads, bridges, mass transit, airports, enhanced communications networks — they are the foundation of an independent manufacturing base and a strong economy.

It means more direct investment in research and development, especially civilian R&D where both Germany and Japan outspend us. It means making our financial environment hospitable to long-term investment, and encouraging savings so that we can obtain funds for investment from domestic as well as foreign sources. And it means fixing our health care crisis, which is causing American business to suffer a terrific competitive disadvantage.

> ***Our massive debt has done such damage to the economy that the first claim on any dividend must be deficit reduction. The growing mountain of debt has sapped savings and investment.***

As with tax credits, not all spending programs are of equal merit. Our resources are limited, and we must focus on those that are most effective in encouraging long-term investment.

The final part of this dividend should go to the real heroes of the cold war — the American family — for their years of hard work, patience, and perseverance. Several proposals in Congress would provide such a reward, most targeted to the middle class. It is clear that a tax relief bill will be the centerpiece of the legislative agenda for both parties next year. I support this effort, but we must realize that we are not in a purely cyclical recession. We are reaping the bitter fruit of a decade of high deficits and underinvestment. We won't cure the underlying problem solely with traditional fiscal medicine. So whatever tax relief is proposed or enacted, it should be consistent with our long-term competitiveness strategy.

An economic future for America that we all want will not be easy. There are those who will preach quick or painless solutions, or ideological solutions. We must reject them all. It will take patience, courage, and leadership. But, we must meet the challenge because it is right — right for our country, right for ourselves, and right for our children.

Senator Max Baucus, Democrat from Montana, is a member of the Senate Finance Committee and Chairman of its Subcommittee on International Trade. This column is digested from the speech he gave November 20, 1991, after receiving the Foundation's annual Distinguished Service Award for the Public Sector.

Paul O'Neill
Chairman & CEO
Alcoa

Fiscal Policies for the New World Order Demand Drastic Tax Code Revision

Let me tell you about a new circumstance that has affected our company, our industry, and our country in the last couple of years — a circumstance which is frankly quite a surprise to me. Remember that two years ago, the Berlin Wall came down. That was a critical turning point in the lifetime of our generation, and it gave me a sense of exhilaration.

Today, such a short time later, we are seeing the political and economic dissolution of the Soviet Union. Frankly, it hadn't occurred to me that the consequences of that dissolution would be found so quickly and importantly in our own company. You might wonder how that could possibly be — let me teach you a little bit about our industry.

In the western world, there are about 16 million metric tons of annual capacity to produce aluminum, and for a very long time, I suppose, there have been 4 million metric tons of capacity in the Soviet Union. But until two years ago, the 4 million tons of capacity in the Soviet Union might as well have been in the moon because it was of no consequence to the west. It was consumed by the Soviet defense economy and by the private economy to the degree that it was used in their consumer goods.

With the dissolution of their political system, they have begun sending enormous quantities of aluminum material into the west. Most businesses have not seen this yet, but in our business, it has had such a significant effect that today, world prices for primary aluminum are 50 percent of what they were two years ago. In fact, they are lower than they have ever been.

I relate this story from our industry to a tax audience because it makes the point that the world is not only getting smaller all the time — it has gotten smaller in an important way, in a big hurry, and quite by surprise. I submit to you that until recently, we in the U.S. have been able to ignore most of the world, and frankly, I think our tax system is a testament to a worn out idea: that we live in an island economy and that our tax system need only be rationalized internally. This is no longer true.

I will tell you from traveling the world, international competition is coming with a vengeance. And I don't believe we can any longer afford to have a tax system that is, in effect, a conglomeration of special interest legislation. At least for myself, I would be happy to do without R&D credits and any other kind of credits if I could have in place of the current tax system, one that was very simple to calculate, that was on gross sales or some other easy to measure indicator of economic activity. We must face that prospect and stop acting as though it were good enough to touch up the edges of our system.

Having been in Washington for 15 years, ten of them at OMB, I thought when I was first asked if I would accept this award that it must be for my public sector service because I was present in fiscal year 1969 when this nation ran its last federal surplus. In fact, when I left in 1977, the budget problem was still solvable. I am not so sure it is anymore, without radical change. That is why I urge that it is time for us to think of an ideal tax system that is not so driven by special political interests, one where we are trying to gain narrow marginal advantages against each other. We must open our eyes to the world and realize that the world we are going to leave for those who follow us in the United States is going to be a pale shadow of what was turned over to us by our parents.

More specifically, in the area of tax administration, join me in being appalled by the roughly $50 billion we incur to administer the federal tax system in the corporate sector. When I add the cost of administering taxes to my products, I have not added any value from the customer's point of view. Whether the customers are in Brazil or Rumania or Taiwan, they are not particularly interested in a political process that by our own hand adds cost without value.

Let me say again, the administrative cost of our tax system is a net negative. There is nothing positive about it — the most brilliant minds in my corporation are required to be in tax jobs because the system we have is such an abomination. But without that brilliance, our corporation would be at risk compared to the competition. It is a terrible misuse of human capital.

International competition is coming with a vengeance. And I don't believe we can any longer afford to have a tax system that is, in effect, a conglomeration of special interest legislation. At least for myself, I would be happy to do without R&D credits and any other kind of credits if I could have in place of the current tax system, one that was very simple to calculate, that was on gross sales or some other easy-to-measure indicator of economic activity. We must face that prospect and stop acting as though it were good enough to touch up the edges of our system.

Now, with all of that, you might understand why it is when I read about tax simplification and the concepts that are being discussed are so arcane, I can't even figure out which subparagraph is going to be modified, that it doesn't measure up to my idea of tax simplification.

I frankly think we need to tell ourselves, and we need our political leaders to tell us, that the time for games is over. We must stop saying that business must pay its fair share because we all know that's a cruel joke on the American people. Business does not, in fact, pay the taxes — taxing business is just a way to confuse people. At the end of the day, we as individuals pay whatever taxes are paid.

I would submit to you that until we have the political maturity to face these facts, we are going to continue on the slide we are on, and as for me, I am going to do everything I can within my company to make sure we are not a part of it.

Paul O'Neill, Chairman and Chief Executive Officer of Alcoa, received the Foundation's 1991 Distinguished Service Award for the Private Sector. This column is digested from his acceptance speech.

Conference from page 3

typical family tax burden has risen approximately 60 percent.

Moving up the income scale, Williams made a point heard less often. "Wealthier taxpayers usually play the villain's role in the fairness debate, but IRS income tax data for 1989, the latest year available, show the top 10 percent of income earners in this country paid about 55 percent of the total tax burden."

He then introduced the four panelists who addressed this increasingly hot political question: Bruce Bartlett, Deputy Assistant Secretary for Policy Analysis, Department of the Treasury; Wendell Primus, Chief Economist, House Committee on Ways and Means; Norman B. Ture, President, Institute for Research on the Economics of Taxation; and Paul W. McCracken, Edmund Ezra Day Professor of Business Administration, University of Michigan.

Bruce Bartlett shed light on basic income distribution data, published by the Census Bureau, which divides the nation's households into five 20-percent income brackets, or quintiles, and Bartlett's analysis of 1982 and 1989 showed all quintiles with higher real incomes in 1989. Acknowledging that the highest quintile's income rose the most, 21.6 percent, he pointed out that the lowest quintile's gain, 13.6 percent, was also substantial.

Bartlett asserted that mobility among the Census quintiles is substantial and quoted a University of Michigan study which found that between 1971 and 1978, half of all people in the highest and lowest quintiles shifted up or down.

He cautioned against data based on cash income only. This excludes the effects of the tax system and the in-kind benefits paid out to people, such as government housing subsidies and food stamps. He warned, "The danger is that people rightly become frustrated. They say, 'We are spending billions and billions of dollars a year to help the poor and raising taxes on the rich, yet the income distribution gets more unequal. Why is that?' It is because we have excluded all these things we are doing from the calculation."

Wendell Primus also shed light on the income distribution data used in the fairness debate, but the light was shining from a different direction. "My preferred measure is to take family cash income and divide by a family size adjuster . . . implicit in the poverty thresholds. This expresses income as a multiple of the poverty line." With this method, Primus sees a four percent income loss from 1973 to 1989 for the average member of a family in the lowest quintile and an average gain in the top quintile of 28–29 percent. He observed that the elderly in all quintiles had fared very well while families with children have slipped badly, leading to numerous tax cut proposals aimed at families with children.

Norman Ture addressed the most basic issue of tax fairness — the question of whether progressive taxes are indeed fair from a moral and ethical perspective. "The conventional view of fairness is that income inequality itself is unfair." Ture asserted that equal status before the law was the only true criterion for fairness and that those people in society who are poor for whatever reason, be they young and unskilled, physically or mentally unable to work, or simply unwilling to undertake activities that others will pay for, are not poor because the rich have extracted wealth from them, so no legal remedy is called for.

"A progressive tax system is by its very nature as unfair as it can be against this criteria of fairness," Ture said. "In effect, the greater your capacity, the greater the effort you put into work from which others benefit, the more productive you are, the higher your income is, the lower your status before the law."

Sidney Jones, Assistant Secretary of the Treasury for Economic Policy, fields questions from two financial reporters after his presentation.

Paul McCracken called for more theoretical work on what distribution of income is most beneficial to the economy. Much greater study is needed on the incidence of taxes, corporate taxes for example, and on the distribution of the benefits of government spending — not just transfer payments, but all government spending.

Commenting that by American standards, economic growth has been very slow in the last couple decades, McCracken pointed out, "One of the basic problems is that government has been growing too fast in any case, putting pressure on the revenue side as well as the expenditure side. If you look at the last ten years, government expenditures have been equal to 41 percent of the rise in net national product. . . . From 1988 to 1990, total government expenditures were 48 percent of the rise in net national product. That marginal rate is too high, and there is a good deal of analytical evidence that countries with that rate of growth in government spending will show slower rates of economic progress."

America in the World Economy – International Competitiveness

"Tax Policy in a Global Economy: How Well Can the U.S. Compete?" was the theme of the second conference session. It examined the role that tax law plays in the ability of U.S. and foreign-owned multinationals to compete in a global market. Panel moderator William Glasgall, International Economics Editor at *Business Week*, introduced Sidney L. Jones, Assistant Secretary for Economic Policy, Department of the Treasury; Alan Auerbach, Professor of Economics, University of Pennsylvania and consultant to the Joint Committee on Taxation; Ray Haas, International Tax Partner, Ernst & Young; and Lawrence Kudlow, Senior Managing Director and Chief Economist, Bear Stearns & Co.

Sidney Jones said that a primary reason fiscal policy adjustments may be necessary to promote U.S. competitiveness is our long-term decline in economic growth. Another is the new portability of technology which puts a premium on productivity. Of course, many tools for stimulating growth involve tax incentives. "In 1988, 1989, 1990 and 1991 we've asked for growth incentives and tax incentives," Jones said, "[but] while we are much in favor of lower taxes, we must be straightforward with the nation. If we are going to spend 24–25 percent of GNP on federal government outlays, 95 percent of which are consumption, and we are only willing to raise 19 percent in tax revenues, we will run a 4–5 percent deficit to GNP ratio."

Alan Auerbach said the U.S. standard of living has slipped for two decades, and asserted that any discussion of competitiveness should relate to that standard — "not so much to the behavior of any one industry or short-term issues like relative costs home and abroad. . . . [which] tend to be tied up in macroeconomic considerations, exchange rates, fluctuations in different economies, and ultimately are much more difficult to deal with using tax policy."

After giving pros and cons for private savings incentives and value-added taxation as ways to increase national savings, Auerbach concluded, "We have to keep our eye on the ball here, and the ball is national savings."

Raymond Haas brought the practitioner's perspective to bear on international competitiveness. He encounters two principal hurdles in his work for U.S.-based multinationals which foreign-based companies do not. U.S.-based firms cannot take advantage of special tax incentives offered by developing nations — the U.S. Treasury simply collects what the foreign nation would have collected without the incentive.

> ***"The U.S. foreign tax credit system, which is supposed to be avoiding worldwide double taxation, actually creates double taxation."***
>
> ***–Raymond Haas***

"The second example is . . . that the U.S. foreign tax credit system, which is supposed to be our way of avoiding worldwide double taxation, actually creates double taxation," said Haas, "[and] much more significantly since the Tax Reform Act of 1986."

Haas concluded with a plea for more stability and less complexity in tax law. He cited the R&D tax credit: "For the seventh time in 10 years we are in a period of not knowing what the impact of R&D is going to do to our companies' worldwide tax liability. I just don't think that is productive."

Lawrence Kudlow said most U.S. marginal tax rates compared favorably with those of other major trading nations — except capital gains. "This is a point which is often lost in the debate, particularly, the cumbersome, dreary debate in Washington of late, 'rich versus poor' and the like. . . . We have the highest capital gains tax rate [while] Germany and Japan have rates of zero and five percent respectively. No wonder we are concerned about long-run productivity trends, and no wonder we are concerned about capital formation trends."

Kudlow goes further and declares that the U.S. is poised for a full economic recovery — interest rates are low and inflation is down. "But there is a bone sticking in the throat of the economy, and that bone is the lack of risk taking. . . . Since new companies are the principal creators of jobs, we shouldn't be surprised that we barely created any jobs in the last three years." ■

FOUNDATION MESSAGE

A Wish for the New Year

Floyd Williams
Chief Tax Counsel

The United States could breathe a collective sigh of relief when Congress did, in fact, close shop for the year just prior to the Thanksgiving holiday. Rather than Congress closing the year with a tax increase, as it did in 1990, the tax-writing committees scheduled several days of hearings during the month of December to examine various legislative proposals designed to cut taxes for middle-income taxpayers and to stimulate economic growth. This, presumably, will set the stage for comprehensive tax legislation early next year.

In another act of charity, Congress extended for six months several tax provisions that would have expired at the end of 1991: the tax credit for research and experimentation expenditures, the tax credit for low-income housing construction and rehabilitation, and the targeted jobs tax credit, among others.

While Congress did not increase federal income taxes this year, the news on the tax front was not entirely good for the U.S. taxpayer. That is because many states that find themselves with budgetary problems are choosing to increase taxes rather than reduce spending. For example, thirty states enacted tax increases that will raise a total of $17 billion in new revenue in fiscal year 1992, making fiscal year 1991 the biggest revenue-raising year in history at the state level. This is likely to push this year's Tax Freedom Day of May 8, 1991, to an even later date next year.

More bad news arrived last fall when a Tax Foundation study showed that accelerating taxes will combine with inflation to make the typical American family $362 poorer this year than it was in 1990. This $362 loss is the largest one-year decline in family income since 1981. Notwithstanding two major income tax rate reductions during the 1980s, the typical family's income tax bill has risen by 60 percent over the decade. In 1991, total taxes (federal, state, and local) as a percentage of total income was 35.1 percent, and this figure is likely to increase next year because of higher taxes at the state and local levels.

The point is that Congress should consider the increasing tax burden, at both the federal and state levels, when it considers tax legislation next year to get the economy moving again. Although it is going to be hard to do in an election year, when tax cuts traditionally become a political football, Congress should avoid the temptation to provide a "quick fix," and it should cease engaging in "class warfare," which is to no one's benefit.

If the economy is still faltering when Congress returns in early 1992, with financial institutions failing, real estate depressed in many parts of the country, and the deficit growing due largely to unchecked government spending, the Congressional agenda will be serious indeed. Congress should listen carefully both to what the tax-writing committees discover during their hearings and to what the constituents back home are saying. If after consultation with the American people, Congress and the Administration enact a tax cut, it should be a true tax cut which results in economic growth and job creation, rather than merely a shifting of the tax burden among families. Only through cooperation among the Democrats and Republicans in Congress, as well as the Administration and the people back home, can we expect to arrive at a sound tax and budget policy to restore this country to its pre-eminent position of economic strength as we begin our move into the twenty-first century.

54th Annual Dinner Honors Max Baucus and Paul O'Neill

The Tax Foundation's 54th annual dinner entertained over 300 people at the Waldorf-Astoria in New York City the night of November 20. The evening's honorees were Senator Max Baucus (D-MT) and Paul O'Neill, Chairman & Chief Executive Officer, Alcoa. Each year, the Foundation bestows two Distinguished Service Awards, one for contributions to tax policy in the public sector, and one for the equally critical efforts from citizens in the private sector. (See pages 4 and 5 for digests of Senator Baucus's and Mr. O'Neill's remarks.)

The dinner followed a conference which addressed tax fairness and international competitiveness, and which included a surprise visit by President Ronald Reagan (see page 1). ■

Tax Foundation Co-Chairman James Q. Riordan, (r.), with Richard J. Hiegel (l.), Partner, Cravath, Swaine & Moore, and M. Alanson Johnson II (c.), Executive Vice President, Treasurer & CFO, P.H. Glatfelter Co.

The two recipients of the Foundation's 1991 Distinguished Service Awards, Paul O'Neill (l.) and Senator Max Baucus (c.), pose with Senator Harry F. Byrd, Jr.

TAX
FOUNDAT

W. Bruce Thomas, former Tax Foundation chairman and long-time Policy Council member, retired in October from his position of Vice Chairman - Administration & CFO at USX Corporation. Here Senator Harry F. Byrd, Jr., thanks Bruce for his many years of work for the Foundation.

Left to right at a reception for Senator Baucus and Mr. O'Neill: Dan Witt, Executive Director, Tax Foundation; Charles Corry, Chairman & CEO, USX Corp.; Glenn White, Program Committee Co-Chairman, Tax Foundation; and Paul McCracken, Professor Emeritus of Economics, University of Michigan.

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Tax Features

Moscow Business Conference Addresses International Taxation and Basic Economics in Former Soviet Union

Over 700 business men and women and government officials, 300 American and 400 Soviet and Russian, attended the Moscow Business Conference, which the Tax Foundation co-hosted at the Kremlin December 1-7. Foundation Cochairman James C. Miller III led the American participants who included Ambassador Robert Strauss, Secretary of Labor Lynn Martin, Deputy Secretary of the Treasury John Robson, publisher of *Fortune* magazine James Hayes, and former Secretary of Transportation James Burnley. Soviet and Russian participants included President Boris Yeltsin, President Mikhail Gorbachev, Yegor Gaidar, Deputy Prime Minister for Economic Affairs, Russian Republic; and Arkady Volsky, Deputy Chairman, Committee for the Management of the National Economy.

Tax Foundation Co-Chairman James C. Miller III applauds Russian President Boris Yeltsin after his presentation in the Great Hall of the Kremlin Palace.

Historic developments during the week of the conference including the floating of the ruble and the announcement as the conference adjourned on Sunday, December 7, of the new Commonwealth's formation. A small group from the conference met Saturday with Gorbachev who was quite bitter about the failure of the Republics to enter into the Union Treaty.

A positive attitude towards Western investment was underscored by President Yeltsin's

See Moscow on page 7

FRONT BURNER

Tax Policy Should Attract Venture Capital to Small Business

Sen. Dale Bumpers

Shortly before Congress left town last year, I introduced legislation to reduce the capital gains tax rate on long-term investments in American small business ventures. I have been joined in this legislation by 44 co-sponsors in the Senate, and companion legislation has been introduced in the House of Representatives by Representatives Bob Matsui (D-CA), Jim Moody (D-WI), and Bill Gradison (R-OH).

Unlike other capital gains proposals, my legislation is targeted specifically to new, long-term investments in high-risk small businesses. Moreover, to qualify for the incentive, investments would have to be held for at least five years.

The legislation I have proposed would set up incentives for two categories of investment: investments in the stock of firms with $100 million or less in paid-in capital, and investments in firms with $5 million or less in paid-in capital.

For direct investment in the stock of firms with $100 million or less in paid-in capital, there generally would be a 50 percent tax deduction. The maximum capital gains tax rate would be 14 percent for taxpayers in the 28 and 31 percent personal income tax brackets. The maximum rate for individuals in the 15 percent tax bracket would be 7.5 percent. In order to qualify for these reduced tax rates, stock would have to be held for at least five years. The excluded gains would be a tax preference item for purposes of the minimum tax.

For investments in firms with $5 million or less in paid-in capital, the capital gains tax rates would be reduced further on a sliding scale if

See Bumpers on page 2

Senator Dale Bumpers, Arkansas Democrat, is Chairman of the Senate's Small Business Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

IN THIS ISSUE

Moscow Conference 1
"Front Burner" 1
Corporate Tax Compliance Seminar 2
Corporate Integration Study 4
Foundation Message 7

Bumpers from page 1

the stock is held for six years or more. For such stock that is held for ten years or more, there would be a 100 percent capital gains deduction. The minimum tax would not apply to capital gains realized on those investments.

The thrust of this legislation is to reward investors and entrepreneurs who are willing to take risks and invest for long-term economic growth, not short-term income.

The thrust of this legislation is to reward investors and entrepreneurs who are willing to take risks and invest for long-term economic growth, not short-term income. It calls upon investors to change their portfolio strategy rather than simply rewarding them for doing exactly what they are already doing without any capital gains tax incentive for doing so.

The capital gains incentive provided by my legislation is directly related to America's competitiveness challenge. This is because it would only apply to high-risk, long-term, growth-oriented investments in businesses that will create the technology and jobs of tomorrow and that will help the United States compete in international markets. This legislation looks to the future, both in terms of the policies of the Congress and the nation and in terms of its emphasis on investments that are critical to help America compete in international trade.

The capital gains incentive provided by my legislation is directly related to America's competitiveness challenge. This is because it would only apply to high-risk, long-term, growth-oriented investments in businesses that will create the technology and jobs of tomorrow and that will help the United States compete in international markets.

I must be candid in acknowledging that the investment incentive that I have proposed does lose revenue. Thus, I will insist that the revenue loss be financed on a pay-as-you go basis under the 1990 budget reconciliation law.

I am well aware that those of us who propose tax incentives for savings and investment cannot claim that we have increased savings if we increase the federal budget deficit to pay for it. This would be a zero sum game with the increase in private savings being cancelled out by the decrease in public savings. The key issue is whether we have increased public and private savings on a net basis.

[Since] we have limited discretionary revenue, we must set our priorities very carefully. . . . An incentive for venture and seed capital formation should form the core of any capital gains legislation considered by the Congress.

According to the Joint Committee on Taxation, my legislation would lose approximately $900 million over a five-year period. While this is not an insignificant amount, the revenue loss is small enough that we do not need to raise tax rates on ordinary income or to impose a surcharge on wealthy taxpayers to pay for it. The potential revenue loss associated with my proposal also pales in comparison to the capital gains proposal advanced by President Bush during the 1990 budget summit negotiations, which would have lost $11.4 billion in revenue over a five-year period.

In conclusion, I would like to point out that in an age in which we have very limited discretionary revenue, we must set our priorities very carefully. In terms of priorities, an incentive for venture and seed capital formation should form the core of any capital gains legislation considered by the Congress.

These high-risk, long-term, growth-oriented forms of direct investment are the stimulus our ailing economy needs.

Tax Compliance Issues Aired at Foundation Seminar

Floyd L. Williams, III, chief tax counsel for the Tax Foundation, set the background for the corporate tax compliance seminar by explaining the Foundation's interest in the subject. "One of the Foundation's guiding principles is that the nation's tax system should be as simple as possible because a complicated system imposes a heavy cost on society and undermines compliance. One way we are trying to achieve this objective is through a study now in progress by Professor Joel Slemrod of the University of Michigan. The hope is that he will be able to put a price tag on complying with various tax provisions, either proposed or existing."

Williams then introduced the panelists who were divided into participants from government and industry. John Monaco, Executive Director of the Coordinated Examination Program of the Internal Revenue Service; Scott McLeod, a legislation counsel with the Joint Committee on Taxation of the U.S. Congress; and Robert S. Winters, Legislative Director and House Budget Committee associate staff member to Congressman Bill Thomas (R-CA) comprised the government panel. J.P. LaCasse, Director of Taxes, American President Companies, Ltd.; J. Peter Campagna, Tax Compliance and Planning Manager, Intel Corporation; Patricia Margaret Kaitz, Director of Taxes and Tax Counsel, Nellcor Inc.;

John Monaco, head of the IRS's Coordinated Examination Program. To his left is Scott McLeod, Joint Committee on Taxation.

See Compliance on page 3

Compliance from page 2

Richard C. Lam, Manager – Tax Audits, Chevron Corporation; and Steven Rosner, Manager of Tax Analysis, Pacific Telesis Group were the five industry panelists.

Monaco, who led off, is ultimately in charge of compliance for America's 1,600 largest corporations. His statements are carefully watched by top tax executives such as those present on the panel and in the audience, so his comments were guarded, avoiding any discussion of specific code problems. But he described an encouraging new philosophy of compliance the IRS has recently adopted, which he called Compliance 2000.

MR LaCASSE
MS

J.P. LaCasse, Director of Taxes, American President Companies, Ltd., and Patricia Kaitz, Director of Taxes, Nellcor.

"Six goals of the program are as follows: (1) Make the tax administration systems and laws more conducive to corporate taxpayers determining the proper amount of tax with the filing of their returns and less from the audit process; (2) Relieve taxpayer burdens through tax simplification and improved systems and procedures; (3) Resolve most factual issues at the examination level; (4) Provide proper and timely training and resources to all employees; (5) Improve the effectiveness and efficiency of the examination process; and (6) Substantially improve the timeliness of examinations.

Monaco fielded questions about the statute of limitations, the possibility of giving agents settlement authority, the role the IRS has played and is expecting to play in legislation, and the changes necessary to make our tax laws and procedures easier for corporate taxpayers.

J.P. LaCasse of American President Companies did not hesitate to delve into specifics. "The effort required for us to go through our tax depreciation calculation has more than doubled," said LaCasse. "The alternative minimum tax (AMT), designed to penalize an overly aggressive use of tax deductions, has in reality imposed a tax increase on companies who can least afford it — companies with lower profits due to the recession."

On the foreign tax credit issue: "The 1986 Tax Reform Act, the same legislation which inaugurated the AMT, radically changed the method that we must use to calculate our foreign versus domestic sources of income," said LaCasse. "But despite this radical change, there have been no regulations issued since 1986 on the code section that is applicable to us."

LaCasse briefly mentioned a favorable recent experience — his company had an audit of two tax years which lasted only seven months

J. Peter Campagna of Intel restricted himself to a very specific area: passive foreign investment companies, or PFICs. Never intended to be a loophole closer aimed at corporate taxpayers, the creation of PFICs was supposed to close down offshore mutual funds that allowed taxpayers to defer the income tax on essentially moneymarket deposits that they were making until they actually sold the shares.

After retelling the provision's history, Campagna submitted these suggestions:

- ■ Where the taxpayer is already filing Form 5471, remove all the other PFIC reporting requirements.
- ■ Eliminate duplicate filing requirements.
- ■ Define a company's start-up year as the first year it has positive gross income.
- ■ Make the determination of a PFIC on a qualified business unit basis, rather than corporation by corporation basis.

Comments from the corporate panel continued with Patricia Margaret Kaitz, of Nellcor Inc., raising the concerns of the small-to-medium sized company. "Sometimes we just throw up our hands and say that with the limited staff we have, we can't comply with some of the regulations, as complex as they are," Kaitz declared. "A company our size, about $158 million, files 800 returns, and I hope the people on the Hill will listen and understand that we hope someday to be a very large corporation, but we need to do so by growing and marketing our products internationally, not by growing a tax department."

Richard C. Lam of Chevron Corporation confessed that much of the delay in the audit process is a by-product of corporate growth. "By acquiring other companies, we end up with new accounting systems and new record systems. We inherit the old problems. . . . There is absolutely no reason we should spend 80 percent of our audit time trying to reconstruct records, and 20 percent of the time dealing with the issues. It ought to be the other way around."

On the IRS's side, Lam said, "Agents and case managers must be convinced that they don't need to see every invoice within an account, and that they don't need to analyze every account. Formal document requests and designated summons have become such a powerful tool in the hands of the Service that some of the former give-and-take in the audit process is denied to the taxpayer."

Steven Rosner of Pacific Telesis Group seconded Kaitz's point about the cost of compliance eating up a disproportionate share of corporate resources. "When I started out in the foreign tax area in 1981, I actually did an IRC Sec. 861 calculation allocating expenses between foreign and domestic sources on an eight-column sheet of paper — by hand. Now we spend thousands of dollars on computer software, accounting firms, and legal fees, and we also drain management's time trying to figure out our foreign source allocation. To what end? We are spending time worrying about this rather than trying to expand abroad."

Patricia Kaitz of Nellcor speaks with Richard C. Lam, Manager – Tax Audits, Chevron Corporation, at her left.

After these remarks from the corporate panel, Scott McLeod of the Joint Committee on Taxation noted that tax staffers on Capitol Hill are indeed sensitive to corporate compliance burdens,

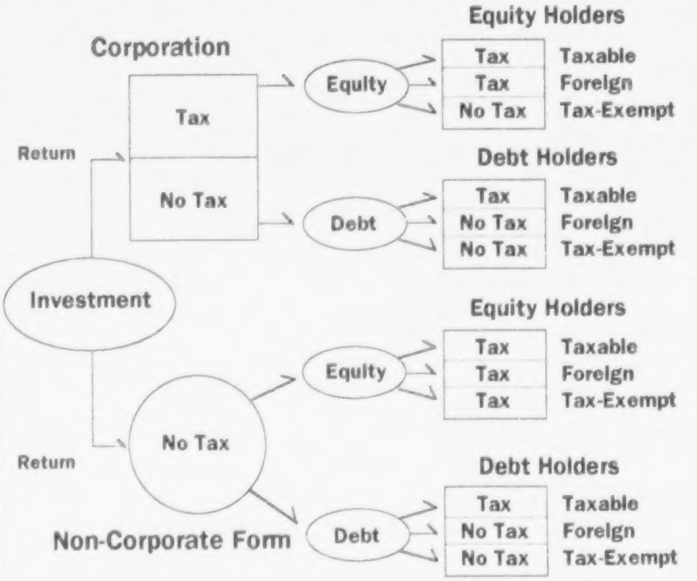
See Compliance on page 6

Long-Awaited Corporate Integration Study Released by Treasury

The Treasury Department released its long-awaited study on corporate integration on January 6. The study asserts that integrating the corporate and individual tax systems is desirable and should be given serious consideration. Titled *Integration of the Individual and Corporate Tax System, Taxing Business Income Once*, the report makes no legislative recommendations but instead outlines four prototype integration systems and details how each would work.

Current U.S. tax law treats corporations and their individual investors as separate entities and levies a tax at both the corporate and shareholder levels on earnings from investments in corporate equity. Therefore, corporate income is subjected to taxation at least twice — once at the corporate level and once at the shareholder level. In fact, corporate profits may be taxed more than twice if they are distributed through multiple unrelated corporations. Stated simply, integration of the individual and corporate income tax refers to the taxation of corporate income only once.

Distortions Under the Current Corporate Income Tax[1]



[1] The figure does not take into account tax preferences or taxes imposed by other countries.

Source: U.S. Department of the Treasury

The importance of examining an integrated U.S. corporate tax system has been heightened by the integration of corporate and shareholder taxes by most of our major trading partners over the past two decades. The primary objective of this integration has been to mitigate the impact of imposing two levels of tax on distributed corporate profits and to reduce the cost of capital for corporate investments. Integration has been most commonly accomplished by allowing the shareholder a full or partial credit for taxes paid at the corporate level.

Corporate integration would attempt to reduce basic distortions created by the current tax treatment of corporate profits, which include: (1) the incentive to finance corporate investments with debt rather than new equity, (2) the incentive to retain earnings or to structure distributions of corporate profits in a manner to avoid the double tax, and (3) the incentive to invest in noncorporate rather than corporate businesses (see figure).

The Treasury report offered four integration prototypes: (1) the dividends exclusion method, (2) the shareholder allocation method, (3) the comprehensive business income tax method (CBIT), and (4) the imputation credit prototype (see table on page 5). The integration method most favored in the study is the dividends exclusion model primarily because it could be implemented with minimal changes to the current law.

Generally, under the dividends exclusion prototype, corporations would continue to calculate their income under current law and pay tax at a 34 percent rate. Shareholders receiving corporate distributions treated as dividends under current law, however, generally would exclude the dividends from gross income. The dividends exclusion method requires corporations to keep an Excludable Distribution Account (EDA) to measure the amount of dividends that can be excluded by shareholders, which would basically represent the amount on which corporate taxes have been paid. Basically, the dividends exclusion method would apply the 34 percent corporate tax rate to both distributed and retained income but would eliminate the shareholder level tax on dividends paid from fully-taxed corporate income.

In addition to outlining four prototype integration systems, the report makes several basic policy recommendations that should be part of any integration proposal ultimately adopted. These include (1) integration should not result in the extension of corporate tax preferences to shareholders, (2) integration should not reduce the total tax collected on corporate income allocable to tax-exempt investors, and (3) integration should be extended to foreign shareholders only through the treaty negotiations, not by statute (this is to assure that U.S. shareholders receive reciprocal concessions from foreign tax jurisdictions).

Although different methods of integration are outlined in the Treasury study, they reflect a common goal: to allow fundamental economic considerations rather than tax code considerations to guide business investment, organization, and financial decisions. For example, the Tax Reform Act of 1986 made the tax system significantly more neutral in its impact on business decisions about capital investment by reducing marginal tax rates. The 1986 Act however, did not address tax code distortions of business organizational and financing decisions. Thus, Treasury suggests that corporate integration may be regarded as a second phase of tax reform for the U.S., extending the goals of neutral taxation to the choice of business organization and financial policy.

The primary goal of integration is to improve economic efficiency by enhancing neutrality in the taxation of capital income. Treasury's report suggests that four goals should be incorporated in the design of an integrated tax system: (1) integration should make taxation of investments across the various sectors of the economy more uniform, (2) integration should make more uniform the taxation of returns earned on alternative financial instruments, particularly debt and equity, (3) integration should reduce the distortions present in the choice between retaining and distributing earnings, and (4) integration should create a system that taxes capital only once.

With the increased integration of international markets for products and capital, the corporate tax system must allow U.S. firms to be internationally competitive. While this current corporate integration study will prompt congressional tax committee hearings this year, any legislative action is likely to be years down the road. ■

Comparison of the Four Principal Integration Prototypes

	Prototype			
Issues	**Dividend Exclusion Prototype**	**Shareholder Allocation Prototype**	**CBIT Prototype**	**Imputation Credit Prototype**
Rates a) Distributed Income b) Retained Income	Corporate rate Corporate rate (additional shareholder level tax depends on the treatment of capital gains)	Shareholder rate[1] Shareholder rate	CBIT rate (31 percent) CBIT rate (additional investor level tax depends on the treatment of capital gains)	Shareholder rate[1] Corporate rate (additional shareholder level tax depends on the treatment of capital gains)
Treatment of non-corporate businesses	Unaffected	Unaffected	CBIT applies to non-corporate businesses as well as corporations, except for very small businesses.	Unaffected
Corporate tax preferences	Does not extend preferences to shareholders. Preference income is subject to shareholder tax when distributed.	Extends preferences to shareholders.	Does not extend preferences to investors. Preference income is subject to compensatory tax or investor level tax when distributed.	Does not extend preferences to shareholders. Preference income is subject to shareholder tax when distributed.
Tax-exempt investors	Corporate equity income continues to bear one level of tax.	Corporate equity income continues to bear one level of tax.	A CBIT entity's equity income and income used to pay interest bear one level of tax.	Corporate equity income continues to bear one level of tax.
Foreign source income	Foreign taxes are creditable at the corporate level, but shielded income is subject to shareholder tax when distributed.	Foreign taxes are creditable at the corporate level and at the shareholder level.	Foreign taxes are creditable at the entity level, but shielded income is subject to compensatory tax or an investor level tax when distributed.	Foreign taxes are creditable at the corporate level, but shielded income is subject to shareholder tax when distributed.
Foreign investors	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.	A CBIT entity's equity income and income used to pay interest bear tax only at the entity level, and no withholding taxes are imposed on distributions to equity holders or on payments of interest.	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.
Treatment of debt	Unaffected	Unaffected	Equalizes treatment of debt and equity.	Unaffected (unless bondholder credit system adopted)

[1] Plus 3 percentage points of corporate level tax not creditable because the prototype retains the 34 percent corporate rate but provides credits at the 31 percent shareholder rate.

Source: U.S. Department of Treasury

Compliance from page 3

then focused on specific legislative proposals pending in Congress.

McLeod said that proposals which have the support of the Administration, and which he thinks could be included in any tax bill this year, include:

- Simplifying the method of calculating depreciation for purposes of the corporate AMT.
- Simplifying calculations required under the uniform capitalization rules.
- Consolidating the various anti-deferral regimes: the PFIC rules, the foreign personal holding company rules, and others.

He then turned to the amortization of intangibles. "In order to eliminate various disputes, Chairman Rostenkowski's bill, HR 3035, would apply a uniform 14-year period to most . . . purchased intangibles, eliminating the disputes with the Service over whether the assets are separate and distinct from goodwill and going concern value. It will also eliminate the disputes concerning how much of the purchase price is allocable to any particular intangible."

Anticipating protests about the 14-year provision from the software executives in the audience, McLeod explained, "[The result] is draconian when you apply it to software that is purchased off the shelf. But . . . if you are acquiring a trade or business and one of the assets happens to be a very good software system, the taxpayer may attempt to allocate a large portion of the purchase price to the software."

Joel Slemrod, Professor of Business Economics and Public Policy at the University of Michigan, has undertaken a comprehensive study of corporate tax compliance costs for the Tax Foundation.

He tried to offer more hope on that score by saying the proposal was deliberately drafted broadly because it is easier to take a provision out than to add it later.

Robert S. Winters of Congressman Bill Thomas's office stated flatly to the audience that there doesn't seem to be any strong constituency right now for simplification.

As an example, he noted that the passive loss rules that have been a major concern of Congressman Thomas are estimated by the Joint Tax Committee to bring in $5 billion, and Winters thinks that to do something about them under the pay-as-you-go regime would require corporate surcharges or a higher AMT rate.

Winters closed by urging corporations to come to legislators as often as possible with ideas for simplifying corporate tax compliance — but also to come with ideas for evening up the federal till if the simplification measures they want will reduce federal revenue.

Moderator Floyd Williams then introduced Professor Joel Slemrod, Professor of Business Economics and Public Policy at the University of Michigan and Director of the Office of Tax Policy Research at the School of Business Administration. Slemrod has undertaken a comprehensive study of corporate tax compliance costs for the Tax Foundation.

Slemrod acknowledged the difficulty of keeping tax simplification on the policy agenda but thinks one way to keep it there is to develop the kind of quantitative measures of complexity's cost that have been developed for the other two goals of the tax system, equity and efficiency.

He asserted that there has not been a definitive study of tax complexity's cost in the United States. "The study for the United Kingdom came up as 0.52 percent of revenue collected."

He went on to criticize the best-known compliance study in the U.S., commissioned by the IRS and done by a consulting firm, Arthur D. Little, principally for not examining enough big businesses.

Slemrod proposes a survey methodology for his study, starting with a small number of corporations, then developing a survey to send to over 100 corporations. He plans to use the results of these 100 surveys to make a model of the cost of complexity. He passed out copies of the pilot draft of the study, so that those interested in providing feedback could do so.

TAX
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Luncheon speaker Robert P. Wayman, Chief Financial Officer, Hewlett-Packard Company.

Robert P. Wayman, Chief Financial Officer, Hewlett-Packard Company, spoke at the luncheon following the event. He compared the U.S. with its fast-growing competitors and sounded the theme of our need to compete effectively in a global marketplace. In this context, he cited taxes as a cost of doing business, with tax compliance as part of that cost.

"We sent a team over to Japan to visit four or five Japanese companies about their finance costs. Some didn't have good information, so we used head counts to give some indication of their finance costs compared to ours," said Wayman. "The largest tax department encountered in these Japanese companies was five people. Ours has 50 people.

"Japanese companies' tax returns are typically completed within two weeks of their statutory accounts," Wayman continued. "And they generally have a two-to-three week audit every couple of years."

Wayman touched on a host of other specific compliance issues: controlled foreign corporations, the 20 percent meals deduction disallowance, auto recordkeeping requirements, records retention, the foreign tax credit, PFIC rules, and many others. ■

Moscow from page 1

address to the conference on Wednesday. He reaffirmed his commitment to create a hospitable environment in the areas of tax law and property rights to attract foreign investment.

Fortuitously, the two panels organized by the Tax Foundation to address "The Philosophy and Economics of Taxation" and "The Technical Aspects of Taxation" were conducted one day before tax legislation came before the Supreme Soviet of the Russian Federation. The U.S. faculty included John E. Chapoton, managing partner, Vinson & Elkins; Ernest S. Christian, Jr., partner, Patton, Boggs & Blow; Dr. Charles E. McLure, Jr., senior fellow, Hoover Institution; Glenn W. White, former director of taxes, Dow Chemical Co.; Bruce S. Brown, vice president of taxes, Philip Morris Companies, Inc.; Harrison Cohen, legislation counsel, Joint Committee on Taxation; Edward Lieberman, partner, Cole Corette and Abrutyn; and Phil Morrison, international tax counsel, U.S. Department of the Treasury.

Russian President Boris Yeltsin addresses the Moscow Business Conference. The image of the hammer and sickle emblazoned on the podium would be a relic within a month of his speech.

Russian participants included Vladimir Scherbakov, cochairman of the conference and president of the Foundation for the Support of Privatization; Andrey Shapovaliantz, Deputy Minister of Finance and Economics; and Viktor Tuhr, Head of Taxation Department, RSFSR Ministry of Finance. Messrs. Shapovaliantz and Tuhr are the principal architects of the new tax law of the Russian Federation; Tuhr is charged with negotiating a tax treaty with the U.S.

The Americans essentially agreed on every important topic. The features of an ideal tax system, based on years of experience in legal practice, international corporate practice, and public policy involvement, were as follows:

See Moscow on page 8

FOUNDATION MESSAGE

In the U.S. – Simplify the Tax Code; In Russia – Make It Simple from the Start

Dan Witt
Executive Director

The Foundation understands that any tax system, whether here in the U.S. or in the new nations of what was the USSR, will always reflect trade-offs in achieving such objectives as simplicity, stability, efficiency, fairness, and economic growth. We do believe, however, that sound principles of taxation should be observed in making those trade-offs.

In the case of the U.S. tax code, simplicity has taken a back seat to practically everything, with the result that our code is a maze from which even experienced corporate taxpayers rarely emerge unscathed. For people contemplating a new business venture, the fear engendered by the IRS and its labyrinth of regulations keeps many potential investors out of the marketplace altogether.

The Tax Foundation kept code simplification issues alive with its seminar on corporate tax compliance December 4th in San Francisco (see page 3). John Monaco, who supervises the IRS's examination of the nation's top corporations, conveyed a positive message with his discussion of the service's new philosophy of compliance. If implemented according to the spirit of his remarks, the new approach, which he calls Compliance 2000, would be a welcome change.

Professor Joel Slemrod, who is authoring a study for the Foundation on corporate tax compliance cost, reminded the audience that in 1984, the Treasury's reform proposal called for fairness, simplicity, and economic growth. In 1985, simplicity slipped to third place in a proposal that demanded fairness, growth, and simplicity. But in final form, the Tax Reform Act of 1986 made no mention of simplicity. With a series of studies and programs, the Tax Foundation hopes to put simplicity back into the vocabulary of Washington taxwriters.

At the same time as corporate executives and government officials confronted the morass of U.S. tax code provisions in San Francisco, the Tax Foundation was sponsoring the Moscow Business Conference in the Kremlin (see page 1). There, instead of trying to remedy an overly complex tax system, the mission was to prevent the creation of a new one.

Foundation Cochairman James C. Miller III led the American faculty, all of whom stressed the vital importance of establishing a relatively simple tax system in Russia and the other republics. From a strictly practical viewpoint, the former USSR's lack of experience with tax compliance and administration is a compelling argument against a complicated tax system.

Complexity absorbs scarce resources and undermines the perception of fairness under the best of circumstances. A direct tax based on consumption, rather than income, was proposed for this reason, as well as for its promotion of capital formation.

How can the Tax Foundation make valuable contributions in venues as far removed as the highly developed field of U.S. corporate taxation and the creation of new capitalist economies in the former USSR? By maintaining objective standards, and by holding all tax systems up to the sound principles of taxation which have made the Tax Foundation a reliable benchmark in the field of tax research for over 50 years.

In Moscow during the changing of the guard: Secretary of Labor Lynn Martin (l.), Tax Foundation Cochairman James C. Miller III (c.), and Foundation Executive Director Dan Witt hold up a spread of news magazines heralding the triumph of Boris Yeltsin.

James C. Miller III, cochairman of the Moscow Business Conference addresses the assembled faculty and delegates. From left: Yegor Gaidar, Deputy Prime Minister for Economic Affairs, Russian Republic; Russian President Boris Yeltsin; and Vladimir Scherbakov, conference cochairman.

- it is fairly simple to administer and comply with;
- it is stable, promoting investment and long-range tax planning by only infrequently changing rules;
- it is neutral, allowing the market to direct investment, favoring neither certain industries nor certain consumer behavior, i.e., saving vs. consumption;
- it is broad-based, with low rates;
- it promotes capital formation by taxing consumption, rather than income;
- any income tax would be creditable.

Tuhr articulated the same goals as the Americans but described important and troubling departures from those principles, including exemptions for profits invested in the production of food, medicine, and selected consumer goods, exemption of the profits of small businesses for the first two years of operation, and preferential taxation of foreign-owned enterprises.

One important area scarcely mentioned by the panel was the fiscal relations among (and within) the republics of the former USSR. The chaos that has plagued both horizontal and vertical fiscal relations in the U.S. and efforts at tax harmonization (more recently "tax convergence") that have been ongoing in the European Community since shortly after the Treaty of Rome, indicate the importance of dealing satisfactorily with this problem at an early stage. ■

Tax Features

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Tax Features

Bush Budget Counters Congressional Family Tax Relief Plans

President Bush has released his new budget which contains several proposals to reduce taxes. But according to Tax Foundation analysis, the bottom line for the typical American family this year is that its tax burden will be higher than ever. A forthcoming Tax Foundation Issue Brief titled *The President's Fiscal Year 1993 Budget and its Impact on the American Family* examines the budget's overall effect on a family of two workers who earn $54,926 and have two dependent children. It goes on to compare the effect of President Bush's plan on this typical family with the likely impact of congressional proposals.

Tax Foundation economist Paul G. Merski testifies before the House Ways and Means Committee, presenting new research on the economic plight of the median American family.

Two workers earning $54,926 with two dependent children will face a federal tax bill of $16,608, or 30.2 cents out of every dollar they earn. (See related article on page 3.)

How the Family Spends What's Left

The family's first obligation after federal taxes is to state and local government. The average state/local take is 9.5 percent, bringing the portion that taxes take from the average family's income to a hefty 39.7 percent.

The family spends the bulk of its remaining disposable income on four items: housing and household expenses – 16.3 percent; food and tobacco – 11 percent; health - 8.8 percent; and transportation – 7.3 percent. After taxes and

See Bush Budget on page 4

Tax Foundation

IN THIS ISSUE

Bush Budget & the American Family 1

"Front Burner" 1

How Federal Government Spends a Tax Dollar 3

Connecticut Tax Policy 6

International Tax Policy Conferences 7

Foundation Message 7

FRONT BURNER

Bush Recovery Package Is Just What the Doctor Ordered

Sen. Robert Dole

At President Bush's request, I have introduced the Administration's "Economic Growth Acceleration Act of 1992." Along with the President's entire budget proposal, this legislation represents an ambitious plan with real substance, real vision, and real solutions for real people. The President's program features much-needed tax incentives for "working and earning America" to help get the economy moving again. Importantly, it does so without busting Congressional spending caps, without jacking up the federal budget deficit, and without putting our nation's security at risk.

The President's "Economic Growth Acceleration Act" contains seven key elements:

- A new $5,000 tax credit for first-time home buyers;
- Penalty-free IRA withdrawals;
- Real estate investment by pension funds;
- Passive loss relief for real estate;
- Job-creating growth incentives, such as a reduction in the capital gains tax rate;
- An investment tax allowance to help businesses purchase new equipment and create jobs; and
- Permanent simplification of the alternative minimum tax.

Let me note that the first four incentives I mentioned will help spark the sluggish real estate market, and help bring the dream of home ownership within the reach of more Americans. Furthermore, under the President's capital gains proposal, 60 percent of the people who will benefit have incomes under $50,000. In addition, the alternative minimum tax measure will curb administrative costs and headaches for many taxpayers.

See Dole on page 2

Senator Robert Dole, Kansas Republican, is Minority Leader in the U.S. Senate and a member of the Senate Finance Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Dole from page 1

This is the first phase of the President's economic package. The second phase proposes additional measures that also mean real money for working Americans. The President's plan will reduce taxes on working families by increasing the personal exemption for dependent children by $500 from the current level of $2,3000.

The President also is seeking to repeal the so-called luxury tax, a phony soak-the-rich scheme that pushed American workers off the aviation and boat production lines and right onto the unemployment lines. Moreover, he has called for an extension of the targeted jobs tax credit, and a permanent research and development tax credit.

The President's program features much-needed tax incentives for "working and earning America" to help get the economy moving again. Importantly, it does so without busting Congressional spending caps, without jacking up the Federal budget deficit, and without putting our nation's security at risk.

President Bush already has initiated an automatic change to the income tax withholding schedule that will put dollars directly into the hands of hard-working middle-income taxpayers instead of into the pockets of Uncle Sam. American taxpayers should understand that this withholding tax relief plan is no gimmick — it is, in fact, real money.

Under the President's capital gains proposal, 60 percent of the people who will benefit have incomes under $50,000.

Every year, the federal government accepts interest-free loans from millions of working American families by withholding too much in taxes. In my view, the last thing the American people want to do is lend their big-spending friends in Congress any more of their hard-earned dollars. In fact, tax return data for 1990 shows that the federal government overwithheld about $70 billion. That means that Uncle Sam owed money to more than 80 million taxpayers.

The alternative minimum tax measure will curb administrative costs and headaches for many taxpayers.

Thanks to President Bush's innovative plan, working Americans will soon be putting more of their wages into their own pockets, instead of Uncle Sam's. Starting in March, millions of workers will see an immediate increase in their take-home pay. Nationwide, take-home pay of low- and middle-income Americans will jump by $25 billion over the next twelve months — that's real money.

The President also is seeking to repeal the so-called luxury tax , a phony soak-the-rich scheme that pushed American workers off the aviation and boat production lines and right onto the unemployment lines.

A major attraction of this withholding plan is that it is uncomplicated. In fact, taxpayers will not have to file any paperwork to take advantage of this Presidential initiative. That's right — no red tape, no aggravating forms, no phone calls to the IRS — the increase in take-home pay is automatic. Workers who use the withholding system as a kind of "forced savings account" may continue to do so by merely notifying their employers to withhold an additional amount to be refunded later.

This adjustment of the tax code may mean smaller tax refunds in 1993, but according to the IRS, nearly nine out of every ten taxpayers who currently receive a refund will still get one.

Critics say this adjustment will not make much of a difference. I say, let the American people decide if they like this plan. If you ask me, working Americans work hard for each and every dollar they earn, and if they want to spend or save those dollars now, who are we to say they cannot?

President Bush already has initiated an automatic change to the income tax withholding schedule that will put dollars directly into the hands of hard-working middle-income taxpayers instead of into the pockets of Uncle Sam.

No one, including myself, will support every item in the President's budget plan; however, taken as whole, the Bush package provides just what the doctor ordered for our economy: tax relief, economic growth, and jobs.

In conclusion, I think it's time for Congress to roll up its sleeves and get to work. The President was right to give us a deadline for action — by March 20th, the President and the American people will expect us to get the job done. President Bush delivered, now it's up to Congress to do the same. ■

Every year, the federal government accepts interest-free loans from millions of working American families by withholding too much in taxes. In my view, the last thing the American people want to do is lend their big-spending friends in Congress any more of their hard-earned dollars. In fact, tax return data for 1990 shows that the federal government over-withheld about $70 billion.

New Bush Budget to Take $16,608 in Federal Taxes from Typical Family in 1992; Will Spend Over 80 Percent on Four Items

A forthcoming Issue Brief by the Tax Foundation shows that President Bush's new budget will take $16,608 in taxes from the typical American family in 1992 to help pay for its record-high federal spending of $1.5 trillion in FY'93. Titled *The President's Fiscal Year 1993 Budget and its Impact on the American Family*, the study examines the budget's effect on a family of two workers who earn $54,926 and have two dependent children.

The study shows that of the typical family's $16,608 federal tax payment, over 80 percent will be commandeered by just four federal spending categories:

- *Income Security*. This is the federal government's biggest bill — over half a trillion dollars. The $501.8 billion that the federal government will spend in this category is primarily Social Security, but it also includes federal retirement and unemployment compensation. Since these income security programs will claim 33 cents from each dollar the American family sends to Washington, the per-family total is $5,411.
- *National Defense*. President Bush is calling for $291 billion in defense spending, still the second largest expenditure in the budget. The family's defense tab this year will be $3,138 — or 19 cents out of each tax dollar.

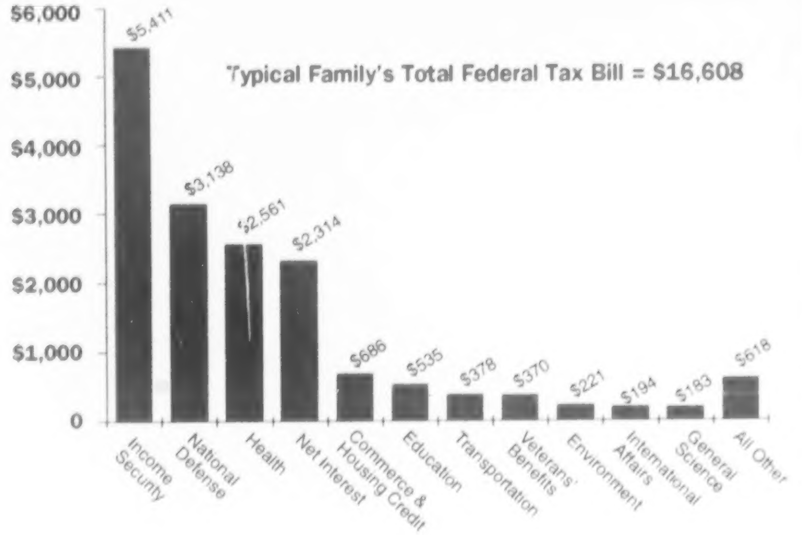
> ***The rate of growth in health spending is reaching such astonishing levels, rising more than 11 percent in FY'93, that it has even surpassed the fast-rising interest on the debt. Both of these categories promise to outstrip defense spending should recent growth trends continue.***

- *Health Outlays*. This skyrocketing expense, comprised mainly of Medicare and Medicaid, will take 15 cents of each tax dollar. The typical family will send Uncle Sam $2,561 in 1992 to pay for the $237.5 billion national health bill.
- *Interest on the National Debt*. Ranking fourth at $214.6 billion, net interest costs account for 14 cents of the family's tax dollar, or a whopping $2,314 per year.

In 1992, these four items alone will cost the typical family $13,424, or 81 cents of each tax dollar. Most notably, the rate of growth in health spending is reaching such astonishing levels, rising more than 11 percent in FY'93, that it has

See Federal Gov't Spending on page 8

How the Federal Government Will Spend the Typical Family's Tax Payment in 1992[a]



Function	Family's Share: Amount	Family's Share: Percent of Total	Total Spending ($Billions)
Income Security (b)	$5,411	32.58%	$501.8
National Defense	3,138	18.89	291.0
Health (c)	2,561	15.42	237.5
Net Interest	2,314	13.93	214.6
Commerce and Housing Credit	686	4.13	63.6
Education, Training, Employment, Social Services	535	3.22	49.6
Transportation	378	2.28	35.1
Veterans' Benefits and Services	370	2.23	34.3
Environment and Natural Resources	221	1.33	20.5
International Affairs	194	1.17	18.0
General Science, Space and Technology	183	1.10	17.0
Agriculture	169	1.02	15.7
Administration of Justice	166	1.00	15.4
General Government	151	0.91	14.0
Community and Regional Development	82	0.49	7.6
Energy	50	0.30	4.6
Total (d)	$16,608	100.00	$1,498.3

(a) This example uses a median two-earner family earning $54,926 per year with two dependent children.

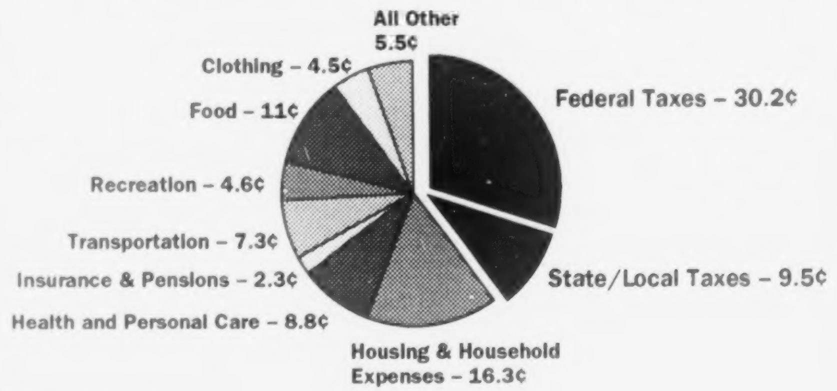
(b) Primarily social security. Includes federal employee retirement, unemployment compensation, and nutrition assistance. Excludes veteran's income security.

(c) Primarily Medicare and Medicaid. Excludes veteran's health care.

(d) After deducting $42 billion in undistributed and offsetting receipts not classified by function.

Source: Tax Foundation computations based on Fiscal Year 1993 U.S. Budget presented January 29, 1992, and 1992 tax laws from U.S. Department of Treasury.

How A Typical American Family Will Spend a Dollar in 1992



Source: Tax Foundation

Table 1

1992 Major Federal Tax Relief Proposals' Impact on Typical American Family (a)

Proposal	Family Income (b)	Income Tax	Social Security Tax	Total Tax	Net Savings
Current Law	$54,926	$6,469	$4,202	$10,671	-
Bush	54,926	6,189	4,202	10,391	$280
Bentsen	54,926	5,309	4,202	9,511	1,160
Bradley	54,926	5,769	4,202	9,971	700
Coats/Grassley/Wolf	54,926	5,542	4,202	9,744	927
Dreier	54,926	5,318	4,202	9,520	1,151
Gore/Downey	54,926	6,157	4,202	10,359	312
Gramm/Gingrich	54,926	6,469	4,202	10,671	(c)
Kasten/Weber	54,926	5,169	4,202	9,371	1,300
Moynihan (d)	54,926	6,469	3,927	10,396	275
Packwood	54,926	5,822	4,202	10,024	647
Rostenkowski	54,926	6,069	4,202	10,271	400
Roth	54,926	4,776	4,202	8,978	1,693
Schulze	54,926	5,797	3,653	9,450	1,221
Walker	54,926	4,852	4,202	9,054	1,617
Wallop/DeLay	54,926	6,469	3,708	10,177	494
	Capital Gains (e)				Net Savings
Bush	54,926	5,839			630
Bumpers	54,926	5,769			700
Gramm/Gingrich	54,926	6,049			420
Kasten/Weber	54,926	5,819			650
Schulze	54,926	6,049			420
Walker	54,926	6,007			462
Wallop/DeLay	54,926	5,819			650
House Republican Conference Committee	54,926	6,049			420
	Savings from First-Time Home Buyer Tax Credit				
	1992	1993			
Bush ($5,000 over 2 years)	$2,500	$2,500			

(a) First-year impact of direct changes in the personal income tax, employee Social Security tax, personal exemption, personal tax credits, and deductible IRA investments.

(b) Estimated median two-earner income for married couple household. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.

(c) Plan allows tax-free withdrawal of IRA and $1,000 tax credit for first time home-buyer not examined in this example.

(d) Additional future reductions in the payroll tax rate are scheduled.

(e) Example assumes $5,000 in fully qualifying capital gains included in the $54,926 income.

Source: Tax Foundation.

Bush Budget from page 1

these expenditures, less than 17 percent of the family's income is available for such items as recreation, clothing, personal insurance and pensions.

How the Plans Stack Up

As part of his budget, President Bush has unveiled a tax relief plan to compete with the many congressional plans introduced in recent months. The President's plan relies heavily on a higher personal exemption for dependent children, a tax preference for capital gains, and a generous credit for first-time home purchases.

Capital Formation and Savings

Bush would reduce the capital gains tax rate by providing an exclusion that would vary depending upon how long an asset is held. The maximum exclusion would be 45 percent for assets held for more than three years; 30 percent for assets held more than two years; and 15 percent for those held at least a year. Under this proposal, the top capital gains tax rate for assets held more than three years would drop from 28 to 15.4 percent. The capital gains tax rate for those in the 15-percent individual income tax rate bracket would be 8.25 percent.

In addition, the President's proposal would make investment in new equipment more attractive for business by providing an additional first-year depreciation allowance equal to 15 percent of the purchase price of newly acquired equipment. This provision would apply only to property acquired on or after February 1, 1992, and before January 1, 1993, and placed in service before July 1, 1993. Moreover, the adjusted current earnings depreciation adjustment, under the alternative minimum tax, would not be required for firms that place new equipment in service on or after February 1, 1992. Thus, regular tax depreciation rules would apply for purposes of the alternative tax.

The President's proposal would increase the incentives for investment in economically distressed areas (enterprise zones) by providing a refundable tax credit for qualified employee wages, eliminating capital gains on eligible zone property, and allowing expensing for certain capital investments in enterprise zone businesses.

Individuals would be permitted to establish flexible IRAs to which they could make nondeductible contributions of up to $2,500 in the account for at least seven years prior to withdrawal, then withdrawals would not be taxed.

Finally, the research and experimentation tax credit would be made permanent.

Tax Relief for Real Estate and Home Buyers

One of the most controversial provisions in the President's plan would generally exempt from the passive loss restrictions a person's active real estate development operations. Also, several technical changes are proposed to facilitate the extent to which pension funds can invest in real estate. Moreover, mortgage revenue bond authority and the low-income housing tax credit would be extended for 18 months.

Despite the prospect for tax relief, however, taxpayers are facing an extra $52 billion in recently legislated tax increases for 1992. States passed $17 billion in new taxes — in some states more than $200 per person — while $35.4 billion in new federal tax collections will kick in from the passage of the Omnibus Budget Reconciliation Act (OBRA), signed into law by President Bush on November 5, 1990.

A key provision designed to stimulate housing construction would allow first-time home buyers to receive a tax credit equal to 10 percent of the purchase price of a home ($5,000 maximum credit) spread evenly over two years. The credit would be available for purchases on or after February 1, 1992 and before January 1, 1993. In addition to this tax credit, first-time home buyers could withdraw up to $10,000 from their IRAs (without penalty) to purchase a home.

Finally, home owners who incur capital losses on the sale of their personal residences would be allowed to claim casualty loss deductions. Thus, a capital loss on the sale of a personal residence would be partially deductible.

Expiring Tax Provisions

The research and experimentation tax credit would become permanent, as would the "orphan drug" credit. The mortgage revenue bond program, the low-income housing tax credit, small issue bond authority for loans to first-time farmers, the targeted jobs tax credit, business energy tax credits, and the health insurance deduction for self-employed individuals would be extended 18 months (through December 31, 1993).

The President's plan would repeal the excise tax on boats and airplanes.

Tax Relief for Families and Individuals

Several provisions in the President's tax package are aimed toward providing tax relief for families and individuals.

- The personal exemption for depen-

See Bush Budget on page 6

Table 2

1992 Major Federal Tax Relief Proposals' Impact on Typical American Family (a)

Proposal	Family Income (b)	Income Tax	Social Security Tax	Total Tax	Net Savings
Current Law	$30,000	$2,220	$2,295	$4,515	-
Bush	30,000	2,070	2,295	4,365	$150
Bentsen	30,000	1,320	2,295	3,615	900
Bradley	30,000	1,520	2,295	3,815	700
Coats/Grassley/Wolf	30,000	1,360	2,295	3,655	860
Dreier	30,000	1,728	2,295	4,023	492
Gore/Downey	30,000	1,310	2,295	3,605	910
Gramm/Gingrich	30,000	2,220	2,295	4,515	(c)
Kasten/Weber	30,000	920	2,295	3,215	1,300
Moynihan (d)	30,000	2,220	2,145	4,365	150
Packwood	30,000	1,998	2,295	4,293	222
Rostenkowski	30,000	1,820	2,295	4,115	400
Roth	30,000	1,536	2,295	3,831	684
Schulze	30,000	1,860	1,995	3,855	660
Walker	30,000	1,665	2,295	3,960	555
Wallop/DeLay	30,000	2,220	2,025	4,245	270
	Capital Gains (e)				**Net Savings**
Bush	30,000	1,882			338
Bumpers	30,000	1,845			375
Gramm/Gingrich	30,000	1,995			225
Kasten/Weber	30,000	1,845			375
Schulze	30,000	1,995			225
Walker	30,000	1,972			248
Wallop/DeLay	30,000	1,845			375
House Republican Conference Committee	30,000	1,995			225
	Savings from First-Time Home Buyer Tax Credit				
	1992	1993			
Bush ($5,000 over 2 years)	$2,500	$2,500			
Bob Graham	2,000				
Gramm/Gingrich	1,000				
Walker	1,000				

(a) First-year impact of direct changes in the personal income tax, employee Social Security tax, personal exemption, personal tax credits, and deductible IRA investments.

(b) Estimated income for married couple household. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.

(c) Plan allows tax-free withdrawal of IRA and $1,000 tax credit for first time home-buyer not examined in this example.

(d) Additional future reductions in the payroll tax rate are scheduled.

(e) Example assumes $5,000 in fully qualifying capital gains included in the $30,000 income.

Source: Tax Foundation.

Bush Budget from page 6

dent children would be increased by $500 per child;

- Interest paid on student loans would be deductible;
- Families could deduct up to $3,000 of expenses incurred in connection with adopting a special-needs child;
- The amount of tax-free mass transit benefits that employers could provide to employees would be increased to $60 per month; and
- Wage withholding would be adjusted so that most married workers would receive $345 more during the year and most single workers would receive $172.50 more during the year.

Based on Tax Foundation analysis of new 1992 tax law, a typical American family taking full advantage of the higher exemption, the maximum capital gains benefit, and the home buyer's credit would reap more tax relief in one year, $3,410, from Bush's plan than from any congressional plan proposed (see table 1 on page 4). A typical family with a more modest income of $30,000 would save $2,988 in one year under the same circumstances (see table 2 on page 5).

The President's proposal would make investment in new equipment more attractive for business by providing an additional first-year depreciation allowance equal to 15 percent of the purchase price of newly acquired equipment.

Despite the prospect for tax relief, however, taxpayers are facing an extra $52 billion in recently legislated tax increases for 1992. States passed $17 billion in new taxes — in some states more than $200 per person — while $35.4 billion in new federal tax collections will kick in from the passage of the Omnibus Budget Reconciliation Act (OBRA), signed into law by President Bush on November 5, 1990. OBRA's tax increases included:

- creation of the 31 percent top marginal tax rate;
- rise in the Medicare wage cap from $51,300 in 1990 to $130,200 in 1992;
- five-cent increase per gallon in the motor fuel tax;
- permanent extension of the 3 percent telephone excise tax; and
- increased taxes on tobacco, beer, wine, and distilled spirits. ■

Foundation To Hold Connecticut State Tax Policy Conference March 31

The recent fiscal crisis in Connecticut has intensified the debate over sound tax and budget policies. To provide a forum for continuing this debate, the Tax Foundation will hold a half-day program featuring state fiscal policy experts from business, government, and academe on Tuesday, March 31, at the Stamford Marriott, Two Stamford Forum, in Stamford, Connecticut. Collaborating with the Foundation on the program are American Brands, Inc., the Southwestern Area Commerce & Industry Association of Connecticut, Inc. (SACIA), the Connecticut Business & Industry Association, and the Connecticut Policy & Economic Council. Speaking to the theme *Connecticut Tax Policy: The Outlook for Economic Growth*, the panelists will debate the underlying causes of the state's fiscal problems and propose viable solutions. The focus will be on specific tax provisions which enhance or impede Connecticut's stability and economic strength over the long term.

Connecticut is not alone in its fiscal woes, so the Foundation is sponsoring state tax policy programs around the country in order to share its findings with other states. ■

All Inquiries: Call Dee Dee Hannum
202-863-5454

8:30 a.m. **Registration/Coffee**

9:00 ***Welcome:***
Dan Witt
Executive Director, Tax Foundation

Session I — Connecticut's Ailing Fiscal Condition: Reasons and Remedies

Moderator
Thomas Appleby
News Director, Cablevision 12

Keynote Speaker
Edward J. Deak, Ph.D.
Chairman, Department of Economics
Fairfield University

William J. Cibes, Jr.
Secretary, Connecticut Executive Office of Policy and Management

Senator John B. Larson (D)
President Pro Tempore
Connecticut General Assembly

Senator William H. Nickerson (R)
Connecticut General Assembly

Eugene C. Gavin
Director of State & Local Taxes
Coopers & Lybrand

Session II — Mapping Out Long-Term Policies for Economic Growth

Moderator
Jacquelyn Durrell
First Selectman
Town of Fairfield

Nicholas S. Perna
Senior Vice President & Chief Economist
Connecticut National Bank

John Carson
President
Connecticut Policy & Economic Council

Frank J. Bianca
Vice President, Taxes
American Brands, Inc.
Member, Connecticut Economic Conference Board

Richard W. Genetelli
President
Genetelli & Associates

Robert K. Neilson
Tax Partner
Price Waterhouse

12:00-1:30 **Luncheon**
Speaker TBA

Registration Form

Connecticut Tax Policy Conference – $35
March 31, 1992 at the Stamford Marriott

Name ____________________

Company ____________________

Address ____________________

City ____________ State ________ ZIP ________

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Tax Foundation Conferences in Western Europe Explore U.S. Tax Policy Problems

For the second year in a row, the Tax Foundation hosted an international taxation conference in Europe, which, by all accounts, was a tremendous learning experience. In January, the Tax Foundation hosted meetings in London, Paris, Brussels, and Berlin. Their purpose was to bring together U.S. businesses, officials from the U.S. Congress, foreign businesses, and foreign tax and trade officials to discuss common concerns relative to outbound and inbound investment. Major topics of discussion in-

Daniel L. Lundy, Senior Vice President & Director - Taxes, ITT Corporation.

James Dobbins, U.S. Ambassador to the European Community.

See EC on page 8

FOUNDATION MESSAGE

Let's Send the Train Down the Right Track

Floyd Williams
Chief Tax Counsel

Whenever Congress starts getting serious about tax legislation, we start hearing analogies, inside the beltway, about trains, such as "the train is getting ready to leave the station," or "only one train will be pulling out this year." The gist of these analogies is that once Congress starts moving on tax legislation, you had better be ready to act quickly. Otherwise, your special interest may get left behind and you may not have another chance to have it addressed for some time.

So far, Congress appears to be moving quickly on tax legislation in response to President Bush's challenge to enact an economic growth package by March 20th. Does this mean that tax legislation will be enacted by this deadline? That is not likely; however, the options should all be on the table by then. From what we have seen of the options thus far, the train might be well advised to stay in the station awhile longer. In fact, it might not be disastrous if no tax legislation were enacted this year if it means raising the tax burden or shifting it among different segments of the population — a point many noted economists already have made.

Certainly, the President's State of the Union Message contained several good ideas. For example, who would argue that working families should not be entitled to some measure of Federal tax relief? (Why then, you might ask, did President Bush strip the increase in personal exemptions for dependent children from the first tax package he sent to the Congress?) Furthermore, most people would agree that the Tax Reform Act of 1986 was unduly harsh on the real estate sector of the economy. In fact, there is no doubt that the subsequent devaluation of property, along with the decrease in construction activity, helped to fuel the current recession and played a major part in the demise of the financial services sector.

The House Democrats already have taken their first shot at a tax package and, like the President, have come up with several good ideas. For example, they would provide a tax credit for working individuals and families, index capital gains for inflation, provide limited relief from the passive loss rules for active real estate developers, and make the research and development tax credit permanent. However, many of the positive changes would be offset by the addition of a fourth individual income tax rate bracket of 35 percent and an increase in the individual alternative minimum tax to 25 percent.

Offering tax relief to the middle class by reshuffling the tax burden among income classes cannot do much for long-term economic growth. Furthermore, Congress should couple its efforts at tax relief with measures to control spending.

The 1986 Tax Act weeded the code of many "loopholes" in order to bring down both the individual and corporate income tax rates. The budget agreement in 1990 resulted in some backsliding. Are we ready so soon to raise taxes again on individuals?

Hopefully, the economy is beginning to show signs of a recovery. Moreover, interest rates and inflation rates are relatively low. Maybe the Congress would be well-advised to wait awhile rather than risk the real possibility of eliminating entirely the rate reductions promulgated in the Tax Reform Act of 1986. But if the economy does not pick up and Congress continues its rush to legislate, then hurry and hop aboard the tax legislation train before it pulls out of the station.

EC from page 7

cluded impediments to foreign investment in the U.S., particularly the recordkeeping requirements of Internal Revenue Code Section 6038A, the likely impact of the European Community's unification on the ability of U.S.-owned businesses to compete in Europe, the experience of European countries with the value-added tax, and the need to coordinate tax and trade policies. A detailed report of the issues raised at the 1992 U.S.-European International Taxation Conference will be available soon.

Major topics of discussion included impediments to foreign investment in the U.S., particularly the recordkeeping requirements of Internal Revenue Code Section 6038A.

Congressional staff who attended this year's conference included representatives from the congressional tax-writing committees and staff to key members of those committees. Corporate participants in this year's conference were: Brown & Williamson Tobacco, Inc., Glaxo, Inc., Xerox Corporation, BASF Corporation, Citicorp/Citibank, NA, ITT Corporation, Rhone-Poulenc, Inc., and Nestle Holdings, Inc. ■

Federal Gov't Spending from page 3

even surpassed the fast-rising interest on the debt. Both of these categories promise to outstrip defense spending should recent growth trends continue.

Spending on all other programs pales in comparison. With the remaining 19 cents, Uncle Sam will spend 3 cents of the family's tax dollar on education, and less than 3 cents each on environment, transportation, science, and administration of justice. (See graphic on page 3 for more detail.)

An estimated $353 billion deficit will eventually cost the typical American family thousands of dollars in interest payments and future debt repayment.

The Family's Direct vs. Indirect Taxes

Direct federal taxes — individual income and personal Social Security taxes — will cost the typical family $10,671 in 1992. However, direct levies are by no means the whole tax burden, accounting for only about three-fifths of what the government takes in. To these must be added such indirect taxes as the employer's share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor, and tobacco, and miscellaneous levies, which account for another $5,937.

Direct and indirect federal taxes will claim 30.2 percent of this family's annual income, but even that does not tell the whole story because the federal government spends much more than just the tax dollars it collects. An estimated $353 billion deficit will eventually cost the typical American family thousands of dollars in interest payments and future debt repayment.

The study also includes analysis on how the typical family spends the money it has left after taxes, and how President Bush's economic growth plan compares to major congressional proposals. ■

Tax Features

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Tax Features

Tax Foundation

IN THIS ISSUE

Cost of Congress 1
"Front Burner" 1
Foundation Fellow Wins Grant 2
European Tax Issues 3
Q&A with Pryor on Taxpayer Bill of Rights 2 4
Corporate Compliance Study 6
Foundation Message 7
Member Briefing 8

House Bank Scandal Spotlights $2.8 Billion Cost of Congress

During the controversy involving the bank operations of the U.S. House of Representatives, some congressmen listed as writers of bad checks have pointed out that tax dollars were not at risk when they abused their *de facto* unlimited overdraft privilege. That implies, of course, that they behave differently when taxpayers are indeed footing the bill. But the Tax Foundation's analysis of the cost of Congress, an annual feature of our research program for decades, reinforces the public's skepticism on this point.

The cost of Congress and the rest of the legislative branch is estimated to rise $464 million to a record high $2.8 billion for fiscal year 1992. This staggering 20.2 percent increase over 1991 figures is more than double the hefty 9 percent increase in overall federal spending.

Just the two houses of Congress themselves will cost $1.3 billion to run. Certainly, the most visible portion of this sum is the congressional salary of $129,500, up modestly from last year due to a 3.5 percent cost of living adjustment. This hike is especially modest compared to the 25 percent raise Congress voted itself at the end of 1990.

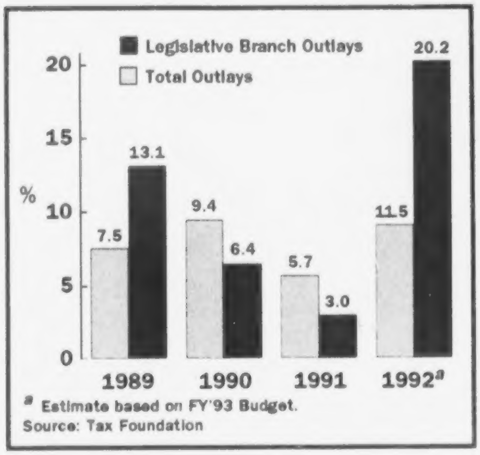
Senate expenditures for FY'92 will reach

See Cost of Congress on page 6

Total Outlays vs. Legislative Branch Outlays

FY1988 - 1992

Percentage Change



ª Estimate based on FY'93 Budget.
Source: Tax Foundation

FRONT BURNER

The Choice Between the Senate Tax Bill and No Bill

Sen. Bill Bradley

On Friday, March 13th, I faced a real dilemma as did all of my colleagues in the U.S. Senate. That day, we had to vote on a tax bill that we knew was going nowhere. We were certain that the President was going to veto it and that we would not be able to override the veto.

I suspect all of us know that the best tax policy for us in the short term is no tax bill. I want to get beyond that issue and get to work on some of the long-term solutions we all know we need — solutions that will lead to less consumption, more savings, more investment, and more and better education and health care, and reduced deficits. At the same time, I would like the Senate's tax bill to be a step in the right direction.

Chairman Lloyd Bentsen was fair, generous, and considerate in putting together a tax bill that tried to address some of the inequities of the past twelve years. In my first discussion with the Chairman about this bill, I let him know about my reservations. He was unfailingly gracious in listening to my concerns, as he was with every other Member of the Senate. In the end, I had to weigh what I thought was the right thing for the country. Sometimes the best policy is the best politics.

Like other Members of the Senate Finance Committee, I fought to get into the bill that which I thought was good. In my case, that meant "self-reliance loans." These loans would have made up to $30,000 available for any American up to the age of 50 who agreed to pay a percentage of his or her future income back

See Bradley on page 2

Senator Bill Bradley, New Jersey Democrat, is a member of the Senate Finance Committee, and Chairman of its Subcommittee on Deficits, Debt Management, and International Debt.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Bradley from page 1

into an educational trust fund. I continue to believe that self-reliance loans are in the national interest because they will help all Americans to go to college, which, in turn, will improve our economic productivity. It was generous of Chairman Bentsen to include self-reliance loans in his bill. I hope that this proposal is contained in any economic package that the Senate agrees to this year and I will continue to push for it in every forum.

There are other provisions in the Senate's tax bill that I supported, such as Chairman Bentsen's small business health care reform, which would have been an important step in the right direction toward comprehensive health care reform. I also supported the millionaires' surtax.

I want to get to work on some of the long-term solutions we all know we need — solutions that will lead to less consumption, more savings, more investment, and more and better education and health care, and reduced deficits.

However, there were problems with the Senate bill. I believe that a tax bill should have one central, coherent purpose. While this bill addressed many important issues, such as the need to bolster the economic resources of American families with children, the need for investment in health and education, and the need for millionaires to pay more taxes, a central goal was absent. In fact, the bill worked at cross purposes. You cannot say that you want to tax the wealthy and then give back $23 billion in special interest loopholes that primarily benefit the wealthy and corporations. You also cannot say you are fighting for the "middle-class-with-kids," much less the entire middle-class, when 25 percent of the poorest children and millions of two-earner families with children cannot fully take advantage of the tax credit.

I fear that the Senate provided the wrong solution to an imagined problem instead of the right solution to the real one. Some will say that I bailed out of a train that was already moving. That is correct. But the question I had to ask was: Is it better to bail out now, or to look back later with regret for having voted for the bill?

You also cannot say you are fighting for the "middle-class-with-kids," much less the entire middle-class, when 25 percent of the poorest children and millions of two-eamer families with children cannot fully take advantage of the tax credit.

In 1981, I opposed the major tax bill. I opposed it because, given the choice between no bill and that bill, no bill was a better idea.

Times are getting tougher in America every day, and working Americans are getting poorer. What people need is the truth. As the gravely ill patient said to the doctor, "Just tell me the truth." The truth is that the Senate's tax bill will not reduce the deficit. The truth is that it is too little too late to jump start the economy. The truth is that it will provide only limited tax relief to a very small percentage of taxpayers. The truth is that it will open up new loopholes that primarily are used by wealthy Americans and corporations. That is why, given the choice between the Senate tax bill and no bill, I chose no bill.

Times are getting tougher in America every day, and working Americans are getting poorer. What people need is the truth. The truth is that the Senate's tax bill will not reduce the deficit. ... [and] that it will provide only limited tax relief to a very small percentage of taxpayers.

Ernst & Young Foundation Awards Grant to Tax Foundation Research Fellow for Study of European Tax Harmonization

The Ernst & Young Foundation has awarded a grant to Professor Tracy A. Kaye of Seton Hall Law School, a Tax Foundation Research Fellow, for her work on tax harmonization in the European Community.

Professor Kaye's study will examine the status of tax harmonization in the EC, as well as the impact of EC tax harmonization on U.S. tax policy. Specifically, this research will examine the issues with respect to the recognition of the EC as a single country for purposes of treaty negotiation with the U.S. and the Subpart F rules of the Internal Revenue Code.

Tracy A. Kaye
Assistant Professor
Seton Hall School of Law
Tax Foundation Research Fellow

The overall objectives of the research will be to:

(1) Determine the effect that indirect tax agreements and direct tax directives will have on the tax systems of the 12 member states of the EC;

(2) Analyze recommendations in the expected report of the independent committee established by the EC Commission on company taxation with respect to their impact on the tax structures of the individual nations;

(3) Assess the impact of EC tax harmonization on U.S. tax policy, specifically addressing such issues as when the EC should be treated as a single country for treaty negotiation purposes and for purposes of the Subpart F rules; and

(4) Analyze current U.S. legislative proposals and make recommendations for changes in U.S. tax policy, taking into consideration the status of tax harmonization in the EC.

U.S.-European Conferees Air Trading Partners' Current Tax Concerns and Anticipate European Community Conflicts

The Tax Foundation's 1992 U.S.-European International Taxation Conference, which took place from January 8-16, 1992, considered a multitude of issues, summarized below. A comprehensive summary of the proceedings, prepared by Professor Tracy Kaye of Seton Hall Law School, a Tax Foundation Research Fellow, will be available next month.

Like 1991's conference, this year's focused on four of the United States' principal European trading partners: the United Kingdom, France, Belgium, and Germany.

The London meetings raised the following issues of concern: treaty overrides, transfer-pricing, and the recordkeeping requirements imposed on foreign-owned U.S. corporations. The United Kingdom's Department of Inland Revenue strongly opposes treaty overrides, suggesting instead that treaty changes should be made through renegotiation. With regard to transfer-pricing issues, the UK representatives believe that the U.S. Congress moved in the right direction in 1990 by seeking to increase enforcement of arm's-length pricing instead of taking a formula approach. The general feeling was that because the tax bases of the U.K. and the U.S. are similar, U.K. companies pay their fair share of taxes in the U.S. and vice versa. The information reporting and record maintenance requirements of Code section 6038A were a major topic of discussion. The main concern has been with the impracticability and expense of the accounting and record creation requirements imposed by Treasury regulations.

The UK representatives believe that the U.S. Congress moved in the right direction in 1990 by seeking to increase enforcement of arm's-length pricing instead of taking a formula approach.

The Paris meetings focused upon many of the same issues discussed in London: treaty overrides, transfer pricing, and recordkeeping requirements. With regard to Code section 6038A, concern was expressed about the requirement that certain corporations maintain prescribed records that are outside the jurisdiction of the U.S. If these records are not maintained, the reporting corporation is subject to severe penalty provisions, as well as harsh noncompliance rules that give the Treasury Secretary broad discretion to allocate income between the reporting corporation and related parties. The worry was expressed that the U.S. Treasury Secretary has such broad powers in regard to the record maintenance requirements as to deny foreign-owned U.S. corporations their fundamental judicial protection.

The worry was expressed [in Paris] that the U.S. Treasury Secretary has such broad powers to increase recordkeeping requirements as to deny foreign-owned U.S. corporations their fundamental judicial protection.

In Brussels, a large part of the meetings focused on an overview of the operations of the institutions of the European Community (*i.e.*, the Commission, Court of Justice, Council of Ministers, Parliament, etc.). It was noted that taxation has the potential for obstructing the free movement of goods, services, and capital, thus distorting trade, and that indirect taxes can have a direct impact on trade. There was also extensive discussion of value-added taxes. It was noted that VAT receipts currently represent about 57 percent of the European Community's revenue. The Council has reached political agreement with respect to harmonizing the VAT rates of the European Community member states. (Currently, the standard rates range from 12 percent in Luxembourg and Spain to 21 percent in Ireland.). Pursuant to an EC directive that is likely to be issued this year, there will be a normal rate for most purchases and a reduced rate for items such as food and housing. Member states must charge a minimum rate of 15 percent. The Commission would like to end up with an origin system, which would reallocate tax receipts on the theory that they belong to the country of consumption. Regarding the issue of U.S. treatment of foreign-owned U.S. corporations, the recordkeeping requirements of Code section 6038A were again raised as a significant concern. In addition, the issue of unitary taxation was mentioned as a concern to European industry. It was noted that the actions of a few states are jeopardizing European investment in the U.S.

Pursuant to an EC directive that is likely to be issued this year, there will be one [VAT] rate for most purchases and a reduced rate for items such as food and housing. Member states must charge a minimum rate of 15 percent.

In Berlin, most of the discussion revolved around investment in the former East Germany and the rest of Eastern Europe. It was noted that while tax incentives may not play a major role in the decision of large companies to invest in the east, they are a very important stimulation to investment by small- and medium-size companies. Also discussed was the pending reform of German corporate taxation. It was noted that German corporate taxes are unfavorable compared to corporate tax rates in many of the other countries, and that this may account for the generally low level of direct investment in Germany by the U.S. and Japan. The current German corporate tax rate is 50 percent.

Pryor Sees Sequel to Taxpayer Bill of Rights (T2) as Crucial Weapon for Taxpayers in Conflict with Internal Revenue Service

On March 16, 1992, chief tax counsel Floyd Williams interviewed Senator David Pryor (D-AR), about his Taxpayer Bill of Rights 2. This proposal would strengthen taxpayer advocacy within the IRS by replacing the Office of Ombudsman with a more powerful Office of Taxpayer Advocate.

Q Congress has been considering legislation to cut taxes and promote economic growth. Why have you chosen this time to pursue your legislation?

A The current debate centers around how to achieve tax fairness for middle-income Americans. I believe this debate should also focus on whether middle-income Americans are treated fairly by the tax collector — the Internal Revenue Service.

Q The first installment of your legislation, the "Omnibus Taxpayer Bill of Rights," was enacted in 1988. Wasn't that enough?

A Many times throughout the almost two-year process of enacting the "Omnibus Taxpayer Bill of Rights," I referred to the legislation as a good first step. Upon its passage, I promised I'd be back because there was much more to do. Well, now I'm back with the Taxpayer Bill of Rights 2, or T2 as we are calling it.

As Chairman of the subcommittee responsible for oversight of the IRS, I receive hundreds of telephone calls and letters from taxpayers who believe they have been wronged. Many of these taxpayers cannot afford to hire counsel to pursue their interests. They simply have no choice but to pay the tax, along with penalties and interest. I have also held hearings as a forum for taxpayers to tell their stories and to hear from taxpayers about how to improve and strengthen the original Taxpayer Bill of Rights. This process has convinced me of the need to expand upon the original bill.

Q Why do taxpayers need a Taxpayer Bill of Rights in the first place?

A The IRS has over 120,000 employees, who process more than one hundred million tax returns and collect over a trillion dollars every year. Let's face it, the IRS is bound to make some mistakes and some employees are going to overstep their bounds. Even if the IRS makes only honest mistakes on only 1 percent of the returns it processes, this would amount to over a million mistakes every year. I simply do not believe that the American taxpayer should be required to pay the price for IRS mistakes and improper actions. There must be safeguards built into the law to protect the taxpayer against the potentially devastating effects of such mistakes and acts. That is why I am seeking to strengthen the Taxpayer Bill of Rights.

Senator David Pryor (D-AR) explains his Taxpayer Bill of Rights 2 to Tax Foundation chief tax counsel Floyd Williams.

Q What were the most significant provisions of the first Taxpayer Bill of Rights?

A That law established the Office of Ombudsman, within the IRS, to act as an independent advocate for taxpayers. Furthermore, it allowed taxpayers to enter into installment agreements with the IRS and prohibited the IRS from using enforcement statistics to evaluate its collections' division employees. The basic thrust of that law was to reaffirm the principle that a taxpayer is the customer of the IRS and to establish a set of rules and procedures to resolve problems stemming from IRS interpretations and administration of the tax law.

Q It seems that the IRS Ombudsman has been fairly successful in assisting taxpayers to resolve administrative disputes with the IRS. How would your new legislation change this position?

A T2 will rename and restructure the Office of Ombudsman. In its place will be the new Office of Taxpayer Advocate. No one really knows what an 'Ombudsman' is, so we are giving the office a name that taxpayers can understand. But most importantly, the Problem Resolution Officers, who are located in IRS field offices, will report directly to the Taxpayer Advocate, who will, in turn, report directly to the IRS Commissioner. Currently, the Problem Resolution Officers are hired, supervised, and promoted by the local District Directors. We believe the restructuring of the Ombudsman's office into the Advocate's office will provide the Problem Resolution Officers with the independence to be more effective advocates for the taxpayer.

The Taxpayer Advocate will have to provide a detailed annual report to the congressional tax-writing committees. Included in this report would be initiatives he has taken to improve taxpayer services and IRS responsiveness; Problem Resolution Officers' recommendations flowing from the field; a summary of the 20 most frequent problems encountered by taxpayers, including a description of the nature of these problems; identification of any Taxpayer Assistance Order that was not honored by the IRS within three days and the reason for delay; and any recommendations for administrative and legislative action as may be appropriate to resolve problems encountered by taxpayers.

Q Under current law, the Ombudsman may issue a Taxpayer Assistance Order (TAO), which requires the IRS to cease taking an action (such as a collection action). How does T2 change this?

A T2 would permit the terms of a TAO to require the IRS to take action (such as issuing a refund faster), in addition to requiring the IRS to cease taking an action, such as staying a collection. Moreover, the requirement that a hardship experienced by the taxpayer be "significant" as a condition for the issuance of a TAO would be deleted. This will allow Problem Resolution Officers to assist taxpayers in avoiding hardships before they occur. The problem with present law is that the standard of "significant hardship" presupposes that a taxpayer must bear some degree of hardship before any relief can be afforded.

Q What types of action will the Taxpayer Advocate be able to take with this broader grant of authority?

A Examples of the broader powers that the Taxpayer Advocate will be able to exercise include the authority to abate assessments and grant refund requests. The Taxpayer Advocate could grant this power to his designees — the Problem Resolution Officers in the field. Moreover, unlike present law, TAOs will be able to be modified or rescinded only by the Taxpayer Advocate or the IRS Commissioner.

Q Could you highlight some of the changes that T2 makes to the installment agreement provisions?

A T2 makes several important changes with regard to installment agreements. For example, present law requires the IRS to give the taxpayer a 30-day notice before terminating an installment agreement if it is determined that the financial condition of the taxpayer has changed significantly. However, in any other situation, the IRS may unilaterally terminate the installment agreement with no notice to the taxpayer. Under T2, the IRS will have to provide the taxpayer with a 30-day notice before terminating an installment agreement for any reason unless the collection of the tax is determined to be in jeopardy. Moreover, the notice from the IRS must include the reason why the IRS considers the installment agreement to be in default.

In addition, T2 will require the IRS to establish procedures for an independent administrative review of a request for an installment agreement, and will require the IRS to provide a written response to a taxpayer who requests an installment agreement. Finally, the IRS will be required to include in the instructions for filing federal income tax returns the rules and procedures for requesting installment agreements.

Q Currently, the IRS may abate interest on any deficiency that results from any error or delay by an officer or employee of the IRS in performing a ministerial act. How would T2 change this interest abatement authority?

A The ministerial act requirement too narrowly limits the possibility of relief to the taxpayer, to the extent that the IRS never abates interest even where the deficiency is its fault. T2 will require the IRS to abate or refund interest attributable to excessive and unreasonable IRS errors and delays where the taxpayer has fully cooperated in resolving outstanding issues. Furthermore, current law does not provide for a judicial review of the IRS decision whether to abate interest. T2 will empower the courts to review these cases.

Q T2 proposes several changes with regard to IRS collection activities. Would you describe some of these changes?

A A significant change would be to require the IRS to issue a notice of proposed deficiency in every instance except when the collection of tax is in jeopardy. This warning notice would have to be mailed at least 60 days before a notice of deficiency. Failure to issue a notice of proposed deficiency would invalidate the notice of deficiency.

T2 also will broaden the IRS's authority to withdraw tax liens. Currently, the IRS may withdraw a notice of lien only if the notice was erroneously filed or if the underlying lien has been paid or bonded, or has become unenforceable. Moreover, the IRS may return levied property only when the taxpayer has overpaid its tax liability. T2 will provide discretionary authority for the IRS to withdraw a notice of a lien in the following situations: (1) the filing of the notice was premature or not in accord with the IRS's administrative procedures; (2) the taxpayer has entered into an installment agreement for the payment of the tax liability with respect to the tax on which the lien is imposed; (3) the withdrawal of the lien will facilitate the collection of tax liability; or (4) the withdrawal of the lien would be in the best interest of the taxpayer and the U.S. If any of these situations occur, then the IRS would be required to return the levied-upon-property to the taxpayer. Also, if the taxpayer requests in writing, the IRS would have to make prompt efforts to notify credit reporting agencies and financial institutions that the notice of lien has been withdrawn.

In addition, T2 would eliminate many of the burdensome requirements that deter the IRS from pursuing offers in compromise. For example, it would clarify that the IRS may make any compromise that would be in the best interests of the U.S., and would raise the threshold above which an opinion of the IRS Chief Counsel is necessary from $500 to $50,000.

Furthermore, T2 will enhance taxpayer protection by requiring the IRS to notify a taxpayer in writing that he or she is under examination and to furnish a copy of "Your Rights as a Taxpayer" prior to commencing any examination.

Finally, the cap on civil damages caused by an IRS employee who recklessly or negligently disregards the provisions of the Internal Revenue Code or regulations would be increased from $100,000 to $1 million, and a taxpayer could recover up to $100,000 for negligent acts.

Q In addition to requiring the IRS to act more responsibly, doesn't your bill also subject information return filers to more requirements?

A That's right. Businesses would have to put their telephone numbers and the name of a contact person on information returns, *i.e.*, W-2 forms, 1099s, etc. Furthermore, any person who willfully files a false or fraudulent information return with respect to payments purported to be made to another person will be subject to a civil action for damages.

See Pryor on page 7

Cost of Congress from page 1

$488 million, $4.9 million per senator, while the House of Representatives' budget calls for $722 million, $1.7 million per representative. In addition, joint expenses have been estimated at $73 million for the current fiscal year.

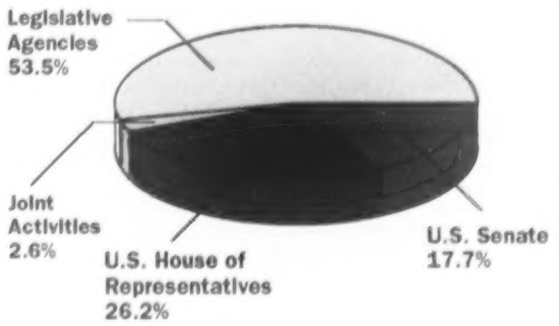
Expenditures for the rest of the legislative branch have also reached record levels, totaling some $1.5 billion for FY'92. These fund various legislative agencies such as the Library of Congress, Government Printing Office, and Architect of the Capitol.

According to recent figures from the Office of Personnel Management, the legislative branch employs 38,662 workers. Of these, the Senate employs 7,584, the House 12,737, and the various agencies 18,312.

The committee system of Congress is comprised of 20 committees and 87 subcommittees in the Senate, employing over 770 professional staff. The House maintains 27 committees and 155 subcommittees, with 1,271 professional staff attached. Finally, joint committees bring the total for the congressional bureaucracy to over 50 committees and 250 subcommittees, employing a professional staff of over 2,100.

Outlays for the Legislative Branch of the Federal Government by Unit

Fiscal Year 1992



Source: Tax Foundation.

Outlays for the Legislative Branch of the Federal Government by Unit

Selected Fiscal Years 1970-1992 (a)

($Millions)

Unit	1970	1980	1990	1991	1992
Total	$343	$1,218	$2,230	$2,296	$2,760
Congress, total	179	582	1,108	1,153	1,283
Senate	58	184	381	392	488
House of Representatives	108	325	585	655	722
Joint activities	13	73	141	106	73
Legislative agencies, total	164	636	1,123	1,143	1,477
Architect of the Capitol	19	89	131	187	312
Botanic Garden (b)	1	2	2	3	4
Congressional Budget Office	-	12	18	20	23
General Accounting Office	70	201	362	393	433
Government Printing Office	34	116	120	75	130
Library of Congress (b)	50	193	479	443	549
Office of Technology Assessment	-	11	18	19	21
U.S. Tax Court (b)	3	10	27	29	32
Other (b)	-	14	4	6	7
Deductions for offsetting receipts	–12	–11	–37	–32	–34

(a) Data for 1992 are estimates from the FY1993 Budget presented in January 1992.
(b) Includes trust funds.
Source: Office of Management and Budget.

Corporate Compliance Study Progresses at Michigan Meeting

Representatives of the Tax Foundation met on March 12 with Professors Joel Slemrod, University of Michigan, and Marsha Blumenthal, University of St. Thomas, to discuss the Foundation's ongoing study of the cost of corporate tax compliance. Representing the Foundation at this meeting were M.D. Menssen, Staff Vice President, Taxes, 3M Company; F.E. Wells, Vice President, Taxes, The Procter and Gamble Company; Bill Stebbins, Assistant Tax Counsel, Chrysler Corporation; and Floyd Williams, Chief Tax Counsel, Tax Foundation. Also in attendance were two key IRS representatives, John Monaco, head of the IRS Coordinated Examination Program, and Richard Teed. John Monaco noted that the IRS wants to take measurable steps to improve its operations, and that finding the underlying costs of compliance will help it to do so. He further indicated that a joint venture among corporate groups, academia, and the government will help the IRS to meet its goals for improvement.

John Monaco, head of the Internal Revenue Service's Coordinated Examination Program

The specific purpose of the meeting was to make final revisions to a confidential survey that will be sent to corporations throughout the country next May. With the results from this survey, the Tax Foundation will better be able to quantify the cost of corporate tax compliance and suggest improvements to policymakers to make the tax system simpler, fairer, and less costly to comply with.

Pryor from page 5

Q Taxpayers often complain about regulations that take effect retroactively. What would T2 do in this regard?

A In general, any proposed or temporary Treasury regulation would apply prospectively from the date of publication of the regulation in the Federal Register. Final regulations could take effect from the date the proposed or temporary regulations are published.

Q Are there any significant provisions of T2, as introduced, that were left out of the Senate bill? If so, do you anticipate a T3?

A There were several items in T2 which, I regret to say, were dropped from the final Senate bill because of revenue concerns. Under the current pay-as-you-go rules, we would have had to raise a significant amount of tax revenue to (1) eliminate the interest differential between the interest paid by taxpayers to the government for underpayments and interest paid by the government to taxpayers for overpayments; (2) provide an automatic installment agreement to taxpayers with tax liability of less than $10,000 and who have not been delinquent in paying their taxes over the past three years; and (3) allow taxpayers filing "Schedule C" (Unincorporated Trade or Business) or "Schedule F" (Farm Income and Expenses) to deduct business expenses without regard to the 2 percent floor. These items are very important and will be pursued in the future.

The more I learn about the IRS, the more I realize that the need for legislation to address taxpayer issues will always exist.

Q What has been the reaction of Treasury and the IRS to T2, and is this any different from their reaction to T1?

A The IRS and the Treasury Department oppose 24 of the 28 provisions in T2. This is nothing new. They opposed the first Taxpayer Bill of Rights. However, in hearings I held in the Finance Subcommittee on Oversight of the IRS, the Commissioner of Internal Revenue admitted that the first Taxpayer Bill of Rights was a good thing. I suspect 4 years from now they will say the same about T2. ■

FOUNDATION MESSAGE

There Was Plenty to Dislike in Both Bills

Floyd Williams
Chief Tax Counsel

In this month's "Front Burner" column, Senator Bill Bradley pointed out that when given a choice between the Senate tax bill and no bill, he chose no bill. Although some of our readers might not agree with all of the reasons for which Senator Bradley voted against the Senate bill, most would probably agree with his decision not to support it. Now that President Bush has vetoed round one of congressional tax legislation, it might be worthwhile to examine the pluses and minuses of both bills.

Both the House and the Senate tax bills would have provided middle-income tax relief through new tax credits. The House bill, for two years, would have provided a refundable income tax credit of up to $400 on joint returns and $200 for single returns. In contrast, the Senate bill would have provided a permanent, nonrefundable tax credit of $300 per child who is under age 16. However, families who earned more than $60,000 per year (hardly qualifying for rich in many parts of the country) would have received no benefit from the credit. Likewise, hard-working Americans who have no children, or who have children over the age of 16, would have received nothing.

What would the price have been for this "tax relief"? The House bill added a new 35 percent rate bracket for individuals with adjusted gross incomes of $85,000 or more ($145,000 or more on a joint return), and the Senate bill added a new 36 percent rate bracket for individuals with adjusted gross incomes of $150,000 or more ($175,000 or more on joint returns). The House bill, but not the Senate bill, increased the individual alternative minimum tax to 25 percent. Both bills imposed a 10 percent surtax on "millionaires." Moreover, both bills extended the limitation on itemized deductions and phase out of personal exemptions for higher-income taxpayers.

Regardless of one's opinion of the current system's fairness, it is hard to conceive how reshuffling the tax rates in order to give a relatively modest tax cut to some middle-income taxpayers will help to spur the economy. Congress' chief domestic policy concern should be enactment of legislation that will spur savings and investment, create jobs, and put people back to work.

That is not to say that there were no good ideas in either the House or the Senate tax bills. Both contained positive elements. For example, repeal of the accumulated current earnings depreciation adjustment (contained in both bills) would simplify life for many corporations and provide welcome alternative minimum tax relief. Moreover, both bills contained some form of capital gains tax incentive. Both bills also provided penalty-free IRA withdrawals for first-time home purchases, and certain medical and educational expenses. The Senate bill also would have restored full IRA contribution deductibility for all taxpayers, and created a new type of IRA to which contributions would be nondeductible but from which withdrawals would be tax free.

Additionally, the House bill (but not the Senate bill) provided 14-year amortization for purchased intangibles. Adoption of this proposal would be a major step toward tax simplification and would reduce tax compliance costs significantly for many businesses. Both bills also contained some form of a new "Taxpayer Bill of Rights," which would provide additional safeguards for taxpayers in many of their dealings with the IRS. Finally, it should be noted that both bills dealt in a generally favorable manner with expiring tax provisions, as well as took some steps to mitigate the unfair treatment that was accorded to the real estate industry by the Tax Reform Act of 1986.

While there is much that could be done to make the tax code simpler and more fair for all Americans, the best course now might be to enact a scaled-down bill to deal with some of the "must do" items, such as the extenders. Longer-term reform might best be left until next year when Congress and the President will not have the distractions of election-year politics.

Foundation Members Briefed on Tax Policy by Lindsey, Hubbard and Moseley

The Program Committee of the Tax Foundation met on February 20th for a briefing at the Treasury Department in Washington on tax policy. Lawrence B. Lindsey, Governor, Federal Reserve Board, and Glenn Hubbard, Deputy Assistant Secretary of the Treasury for Tax Analysis, spoke about the prospects of economic recovery and growth in the context of the President's tax proposals. After this meeting, the group of tax executives adjourned to the Capitol Hill Club for a luncheon, where they heard the view from the other end of Pennsylvania Avenue from Phil Moseley, Chief of Staff (Minority), House Ways and Means Committee.

▲ ***At right, Federal Reserve Board Governor Lawrence Lindsey briefs Tax Foundation Program Committee members at the Department of the Treasury. Tax Foundation executive director Dan Witt looks on at left.***

◀ ***At right, Glenn Hubbard, Deputy Assistant Secretary of the Treasury for Tax Analysis, speaks on President Bush's proposals to stimulate the economy. Federal Reserve Board Governor Lawrence Lindsey is at left.***

Upcoming Foundation Events

What	Where	When
Connecticut Tax Policy Seminar	Stamford Marriott	March 31
Tax Freedom Day Press Conference	Washington, DC	April 15
California Tax Policy Seminar	Los Angeles	May 8
Texas Tax Policy Seminar	Dallas	May 21
TF/NYU Transfer Pricing Workshop	New York City	May 28-29
Tax & Trade Conference	Washington, DC	June 3
Foundation Policy Council Luncheon	New York City	June 25

Tax Features

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Tax Features

Foundation Announces Tax Freedom Day To Be May 5th in 1992

Date Shows Taxes Highest Ever

Nineteen ninety-two's Tax Freedom Day is May 5, four days later than in 1991, according to the Tax Foundation's annual computation of the nation's tax burden. "While most people look at April 15, the federal government's tax return filing deadline, as the day to wash their hands of the tax collector, they are mistaken," said Dan Witt, executive director of the Tax Foundation, at a press conference in Washington, DC, to release the Foundation's study, *Special Report: Tax Freedom Day 1992 Is May 5.* "In reality, the average American has to work another 20 days,

▲ ***Tax Foundation Executive Director Dan Witt announces 1992's Tax Freedom Day.***

▼ ***Reporters assemble on April 15th for the release of the Foundation's Tax Freedom Day Special Report.***

See Tax Freedom Day on page 3

Tax Foundation

IN THIS ISSUE

Tax Freedom Day 1
"Front Burner" 1
Viewpoint on Revenue Estimating 3
Tax Bite in the 8-Hour Day 5
Tax Freedom Day by State 6
Foundation Message 7
Connecticut Tax Policy 8

FRONT BURNER

Taxing and Spending - A Circular Path to Disaster

Rep. Nancy Johnson

Tax Freedom Day's occurrence on May 5th, the latest date ever, mirrors the seemingly inexorable encroachment of higher taxes and government spending on the paycheck of the average American worker.

Even worse for taxpayers in my home state of Connecticut, our state-specific Tax Freedom Day is May 19th, second highest in the country and seven days later than last year. This is largely due to last year's enactment of a broad-based state income tax. After decades of relying on sales taxes and levies on capital gains and business income, this is a terrific blow to working people, will almost certainly prolong the recession, and fails to attack the root cause of the problem.

The root cause has been years of unjustifiable spending increases. Between 1974 and 1984, state spending rose an astounding 150 percent; in 1988-89, the trend continued with a 16 percent increase; in fiscal year 1989-90, the increase was "merely" 8.5 percent, or $547 million. Spending increases like these were indefensible when many working people were not receiving even a cost-of-living increase in pay. Now, with thousands losing their jobs and a nearly nine percent real increase in spending in the latest state budget, a 4.5 percent income tax rate — which cuts into individual spending — is unfair and destructive.

As over-spending was the cause of our state's budget problems, what we needed to do in the last budget cycle was to lower the spending base and rein in spending growth. Unfortunately, neither was accomplished, and I know from experience that this will keep us on

See Johnson on page 2

Nancy Johnson is a Republican Member of Congress from the Sixth Congressional District of Connecticut and serves on the House Committee on Ways and Means.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Johnson from page 1

the circular path to disaster: new taxes bringing in new revenue to fuel new spending. Add a bunch of zeroes to the numbers in this scenario and you see the scope of the problem at the federal level.

Like most Americans, I believe that the imposition of new taxes is not the solution to our budget problems. Throughout my five terms in the House of Representatives, I have consistently opposed profligate federal spending and advocated cutting it or at least freezing it at current levels.

Even worse for taxpayers in my home state of Connecticut, our state-specific Tax Freedom Day is May 19th, second highest in the country and seven days later than last year. This is largely due to last year's enactment of a broad-based state income tax.

I am one of the few Members to propose concrete alternatives to the business-as-usual budget plans offered by the House majority leadership, including specific amendments to reduce appropriations (spending) bills to cut out unnecessary projects. Though our successes have been modest, the constant pressure of the bipartisan group I work with has limited growth in so-called discretionary spending. In the 1980s, this relatively modest growth was compromised by overly generous increases in defense spending and remarkable growth in entitlements. Between 1991 and 1992, for example, Medicare spending increased from $102 billion to $116 billion, and Medicaid rose a whopping 40 percent, from $52.5 billion to $72.5 billion.

We must strive for potential budget improvements such as cuts in agriculture subsidies, continued closing of outdated military bases, and reformation of the defense procurement process, but these would make only a small dent in the budget. The real challenge lies in slowing the rapid growth of hundreds of government's "entitlement" programs — automatic, inflation-adjusted payments from the government based on eligibility, not on need. These "mandatory" programs, plus interest on the debt, now account for over $980 billion in annual federal commitments and are projected to grow at an average rate of 7.2 percent annually over the next five years.

According to the Office of Management and Budget, this uncontrolled spending now adds up to 64.4 percent of the budget. Just 30 years ago, the figure was 23 percent -- clearly, something has to be done. The announced retirement of a straight-talking ally, Senator Warren Rudman (R-NH), makes the task of doing something about entitlements even more formidable.

As President Bush highlighted in his FY1993 budget submission to Congress, deposit insurance responsibilities are adding to the short-term deficit, but the real killer is lurking in the rapid growth of mandatory programs that are appropriately called "uncontrollable." Out-of-control is more like it.

Two other issues deeply concern me: the unwillingness of congressional leadership to embrace an economic growth package this year, and the possibility that next year's appointments to fill a record number of vacancies on the tax-writing Ways and Means Committee could put thoughtful tax policy debate in 1993 in jeopardy.

The real challenge lies in slowing the rapid growth of hundreds of government's "entitlement" programs — automatic, inflation-adjusted payments from the government based on eligibility, not on need. ... The announced retirement of a straight-talking ally, Senator Warren Rudman (R-NH), makes the task even more formidable.

I was an early, strong voice for an economic recovery package to create jobs and effectively kick-start the economy in a short period of time. Thus, it was very disappointing to watch the congressional leadership trash the President's efforts to revive a moribund economy with a straightforward package of short-term incentives. They were intent on producing a purely political document and that is exactly what we got. Thankfully, the President vetoed the 600-page turkey on the spot.

Turnover at the Ways & Means Committee does not occur very often and I am urging every audience I address to pay close attention and to press for the appointment of men and women who will not use tax policy to drive federal spending even higher.

Through judicious use of the tax code and without creating a costly new bureaucracy, there are several things we could do right now to boost the economy:

- a tax credit for first-time home buyers;
- changes in the passive loss rules for real estate;
- business incentives to buy machinery, equipment, and vehicles;
- relaxation of IRA withdrawal rules for first-time home purchases, college tuition, and medical emergencies; and
- permanent extension of expiring provisions like the low-income housing tax credit and the tax exemption for mortgage revenue bonds.

Regarding the composition of the Ways and Means Committee, at least one quarter of the committee membership will be leaving at the end of the 102nd Congress, to be replaced by Members selected by the parties' leadership early in 1993. Such turnover does not occur very often and I am urging every audience I address to pay close attention to this process and to press for the appointment of men and women who will not use tax policy to drive federal spending even higher.

As Tax Freedom Day slips further and further down the calendar, I am optimistic that, in the long term, the American people, through their elected representatives at all levels of government ,will get this country back on track and make her greater than ever. ■

VIEWPOINT

Single-Entry Revenue Estimating

Neil Wissing
Vice President &
Director of Taxes
Weyerhaeuser Company

As financial record keeping evolved, accountants recognized that a double-entry system of accounts was essential to reflect properly the activities of complex enterprises. It is unfortunate that a similar level of sophistication is not applied to the Federal revenue estimating process. While Congressional and Administration revenue estimators deny limiting their calculations to "static" effects, the practicalities are that they consider, at the most, only direct "feedback" effects of tax proposals while ignoring the significant "macro" impacts.

Proposals to reinstate the Investment Tax Credit (ITC) are illustrative of the misleading impressions which can emanate from this flawed process. Enthusiasm for an ITC restoration is predicated on its ability to stimulate increased economic activity and create jobs quickly. Yet the ITC is "scored" as a revenue loss — a loss which the business sector presumably is expected to make up under "revenue neutrality" constraints. The offsetting economic growth leg of the equation is apparently buried somewhere in the budget's economic assumptions (or under "baseline budgeting," is not reflected at all once the budget is initiated).

> ***The existing revenue estimating system, together with its "black box" syndrome, deserves a prompt burial. Surely the Congress and the Administration merit a modern and dynamic data system — one which incorporates external "macro" models — in which both tax decision makers and taxpayers can have a significantly higher level of confidence.***

This failure to highlight and display the "cause and effect" of a revenue proposal as part of the legislative function is essentially single-entry bookkeeping on a grand scale. It has also become the institutionalized process underlying the flawed decision making which often results from the absence of valid data.

Precisely the same analytical failure occurs in revenue estimates related to the endless tax impediments placed in the path of U.S. multinationals seeking to compete in the global marketplace. Repeal or modification of some of these widely recognized inhibitors to competitiveness is forestalled by Treasury and JCT estimates of potential "revenue losses." Yet neither of these agencies score the Treasury revenues lost as a consequence of the diminished and inefficient business activities of U.S. corporations whose operational and financial processes have been modified to accommodate U.S. tax rules.

The existing revenue estimating system, together with its "black box" syndrome, deserves a prompt burial. Surely the Congress and the Administration merit a modern and dynamic data system — one which incorporates external "macro" models — in which both tax decision makers and taxpayers can have a significantly higher level of confidence.

Tax Freedom Day from page 1

until May 5, to be free of all federal, state, and local taxes."

Tax Freedom Day is the day in the year when the average taxpayer's 1992 federal, state, and local tax obligations would be satisfied if all earnings from January 1 to that date went to the tax collector.

The four-day jump in Tax Freedom Day is a result of the following factors:

- The recession has caused a sharp slowdown in individuals' income growth.
- Federal tax increases: $164 billion in new federal taxes over 5 years due to the Omnibus Budget Reconciliation Act of 1990; and
- A record-setting year for state tax increases ($17 billion legislated for 1992).

The 1992 date of May 5 is actually four days later than the 1991 date of May 2 due to the effect of leap year, which causes Tax Freedom Day to fall a calendar day earlier. It should be noted that the historic dates shown in table 1 on page 5 have been revised from previous releases due to comprehensive revisions in the basic tax and income data used in the computation of Tax Freedom Day.

Tax Foundation Director of Fiscal Affairs Paul G. Merski, author of the Tax Freedom Day Special Report, fields a question at the press conference.

Freedom from Every Tax

The total tax burden amounts to 126 days of work for the average American to support government at all levels. New this year in the Tax Freedom Day study is a breakdown of these 126 days by type of tax. (See figure 1 and the accompanying table.)

For most Americans, income taxes at both the state and federal levels contribute the most to the long wait for Tax Freedom Day. They take the average

See Tax Freedom Day on page 4

Tax Freedom Day from page 3

American over 6 weeks to pay. Additionally, the growing burden of Social Security taxes will have the average person working more than five weeks. Because these taxes are withheld by the government, taxpayers are reminded with each paycheck just how large they are. What many taxpayers may not realize is that the sales and excise taxes they routinely pay will consume more than two weeks' additional pay.

TAX FREEDOM DAY

Executive Director Dan Witt points out that 1992's Tax Freedom Day, May 5th, is the latest on record.

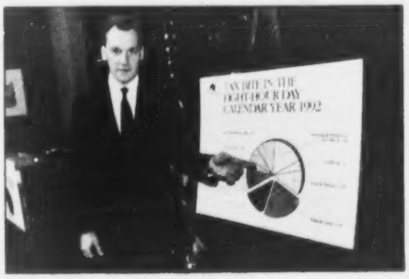
The Recession's Role

Throughout 1991 and into 1992, the lingering recession has significantly lowered personal income growth and personal consumption expenditures, resulting in income and sales tax revenues well below expectations. Similarly, a sharp reduction in corporate profits reduced individuals' shares of corporate earnings and tax liabilities. However, record tax increases enacted under the Omnibus Budget Reconciliation Act of 1990, combined with record state tax increases and a recovering economy, will cause tax revenues to surge in 1992. Slower income growth combined with these federal and state tax increases are largely responsible for the 4 extra workdays needed to reach this year's May 5, 1992 Tax Freedom Day.

Tax Freedom Day Perspective

The Tax Freedom Day methodology is designed to present an accurate and easily understandable description of the impact that government taxation has on the U.S. economy and on the individual taxpayer. As shown in table 1, the number of workdays required to reach that date has increased throughout the years. Improvements have rarely lasted more than one or two years, and usually have been due to economic conditions rather than policy changes.

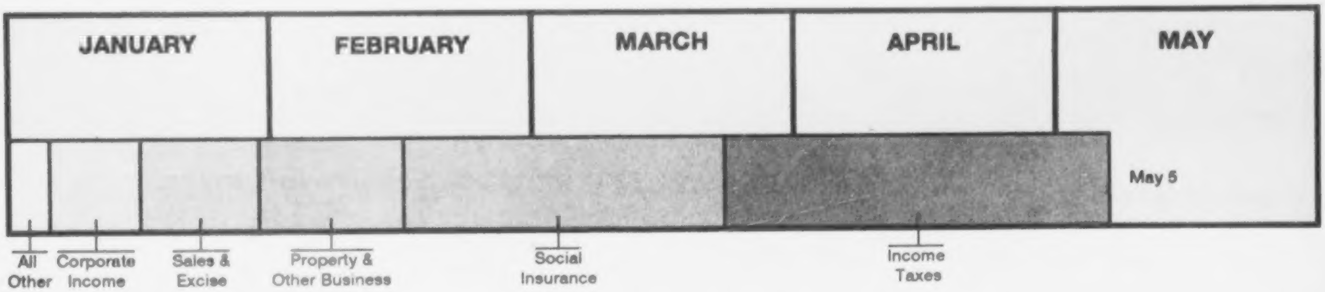
However, some notable attempts have been made to halt the trend of increasing tax burdens. The most recent attempt to change the direction of federal taxation was in 1981, when the Economic Recovery Tax Act of 1981 (ERTA) managed to move Tax Freedom Day back into April for three years, 1983 through 1985. Since then, however, a succession of sixteen tax bills has finally managed to erase any relief resulting from ERTA.


TAX BITE IN THE EIGHT-HOUR DAY CALENDAR YEAR 1992

Paul Merski uses the Tax Bite in the Eight-Hour Day to sketch how the typical American taxpayer spends what's left after working 2 hours and 45 minutes every day to pay taxes.

State and local tax burdens fell for a time, after California's Proposition 13 started a wave of tax limitation measures around the country. Beginning in 1981, however, state and local revenues began to rise again, and only the onset of a recession prevented 1991 from having the latest state Tax Freedom Day ever. Current estimates of growth in government revenues indicate that Tax Freedom Day will most likely fall even later in future years. ■

Figure 1
Tax Freedom Day by Type of Tax
Calendar Year 1992



Tax Freedom Day by Type of Tax
Calendar Year 1992

Income Taxes	Social Insurance	Sales & Excise	Property & Other Business	Corporate Income	All Other
Feb 12	Feb 8	Jan 17	Jan 15	Jan 9	Jan 3

Tax Bite in the Eight-Hour Day Reaches 2 Hours, 45 Minutes in 1992

The Tax Freedom Day methodology provides another graphic way to express the tax burden's effect on the average worker's paycheck: the Tax Bite in the Eight-Hour Day.

In 1992, Tax Foundation analysts estimate that the average worker will spend 2 hours and 45 minutes of an 8-hour day working to satisfy federal, state, and local tax collectors — 4 minutes more than in 1991. One hour and 46 minutes of each day will go towards federal taxes, while 59 minutes will be devoted to state and local taxes.

With 1992's record-setting chunk of the day spent working for the tax collector, the average worker has less to spend on other budget items. The largest portion of what is left is spent on housing and household operations: 1 hour and 22 minutes. See figure below for more details on the average worker's expenditures, and the table for state-specific Tax Bites and the breakdown between federal and state/local impact.

Table 1
Tax Freedom Day and
Tax Bite in the 8-Hour Day
Selected Calendar Years 1929-1992

Year	Tax Freedom Day	Tax Bite in the 8-Hour Day (Hours:Mins)
1929	February 9	:52
1931	February 15	1:00
1933	March 5	1:24
1935	March 1	1:17
1937	March 6	1:24
1939	March 6	1:24
1940*	March 8	1:29
1941	March 17	1:40
1942	March 19	1:43
1943	April 6	2:06
1944*	March 30	1:58
1945	April 1	1:59
1946	March 31	1:57
1947	April 3	2:01
1948*	March 28	1:55
1949	March 24	1:48
1950	April 3	2:02
1951	April 10	2:11
1952*	April 10	2:12
1953	April 10	2:12
1954	April 6	2:05
1955	April 9	2:09
1956*	April 11	2:13
1957	April 13	2:14
1958	April 10	2:12
1959	April 13	2:15
1960*	April 16	2:20
1961	April 17	2:20
1962	April 17	2:20
1963	April 19	2:22
1964*	April 13	2:16
1965	April 14	2:16
1966	April 16	2:19
1967	April 18	2:22
1968*	April 24	2:30
1969	April 30	2:37
1970	April 26	2:32
1971	April 24	2:29
1972*	April 28	2:35
1973	April 29	2:35
1974	May 2	2:40
1975	April 27	2:33
1976*	April 29	2:37
1977	April 30	2:38
1978	April 30	2:37
1979	May 1	2:38
1980*	May 1	2:40
1981	May 5	2:44
1982	May 3	2:42
1983	April 30	2:38
1984*	April 28	2:36
1985	April 30	2:38
1986	May 1	2:38
1987	May 4	2:42
1988*	May 1	2:40
1989	May 4	2:42
1990	May 3	2:41
1991	May 2	2:41
1992*	May 5	2:45

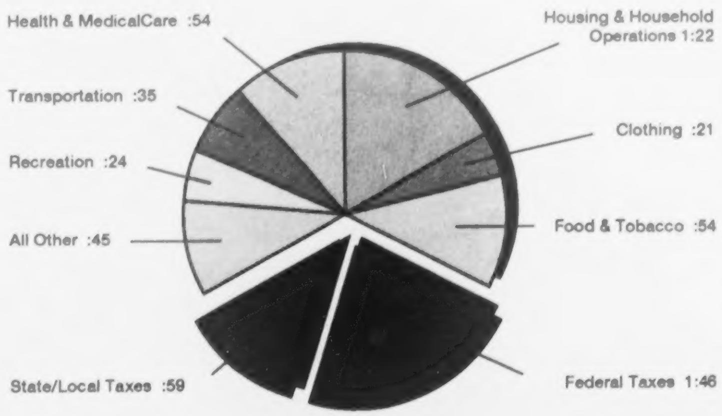
Source: Tax Foundation
* Leap year makes Tax Freedom Day appear a calendar day earlier.

Tax Bite in the Eight-Hour Day by State
Calendar Year 1992

	Hours:Minutes		
	Total Taxes	Federal Taxes	State/Local Taxes
U.S. Total	2:45	1:46	:59
Alabama	2:25	1:38	:48
Alaska	2:47	1:37	1:10
Arizona	2:48	1:42	1:06
Arkansas	2:29	1:39	:50
California	2:49	1:46	1:03
Colorado	2:36	1:42	:54
Connecticut	3:04	1:59	1:04
Delaware	2:57	2:01	:56
Florida	2:33	1:43	:50
Georgia	2:41	1:42	:59
Hawaii	2:46	1:41	1:05
Idaho	2:29	1:34	:55
Illinois	2:47	1:50	:57
Indiana	2:32	1:42	:50
Iowa	2:32	1:37	:55
Kansas	2:36	1:45	:52
Kentucky	2:30	1:37	:53
Louisiana	2:39	1:40	:59
Maine	2:39	1:36	1:04
Maryland	2:43	1:47	:56
Massachusetts	2:45	1:49	:56
Michigan	2:47	1:49	:58
Minnesota	2:51	1:46	1:05
Mississippi	2:25	1:33	:52
Missouri	2:29	1:42	:47
Montana	2:39	1:38	1:02
Nebraska	2:32	1:39	:53
Nevada	2:43	1:45	:58
New Hampshire	2:35	1:49	:46
New Jersey	2:49	1:55	:54
New Mexico	2:42	1:39	1:03
New York	3:09	1:49	1:19
North Carolina	2:37	1:41	:56
North Dakota	2:30	1:39	:51
Ohio	2:41	1:46	:55
Oklahoma	2:34	1:42	:52
Oregon	2:44	1:43	1:01
Pennsylvania	2:46	1:47	:59
Rhode Island	2:51	1:50	1:00
South Carolina	2:30	1:36	:54
South Dakota	2:16	1:32	:44
Tennessee	2:30	1:44	:46
Texas	2:39	1:46	:53
Utah	2:33	1:35	:57
Vermont	2:44	1:42	1:02
Virginia	2:34	1:43	:51
Washington	2:46	1:46	1:01
West Virginia	2:42	1:38	1:04
Wisconsin	2:45	1:43	1:02
Wyoming	2:41	1:42	:59
Exhibit: DC	3:15	1:48	1:27

Source: Tax Foundation.

Tax Bite in the Eight-Hour Day
Calendar Year 1992



State-Level Tax Freedom Days Range from April 13 to May 23

To bring Tax Freedom Day closer to home, the Tax Foundation has expanded its Tax Freedom Day study to calculate a specific Tax Freedom Day for each state and the District of Columbia.

The state-by-state calculations are derived from state-specific income data and geographically accurate tax collection data. They yield a more accurate estimate of the tax burden for taxpayers within each state and provide some basis for comparing state tax burdens.

The Heaviest Tax Burdens

For 1992, New York continues in the unenviable position of having the latest Tax Freedom Day in the country (see table 2). Its taxpayers will work until May 23rd before their tax bills are satisfied. The new date is 3 days later than 1991 and 18 days later than the national average. The following list identifies the 10 states that have the latest Tax Freedom Days:

State	Tax Freedom Day	Rank
New York	May 23	1
Connecticut	May 19	2
Delaware	May 14	3
Minnesota	May 10	4
Rhode Island	May 10	5
New Jersey	May 8	6
California	May 8	7
Arizona	May 8	8
Alaska	May 7	9
Michigan	May 7	10

Recently, many of these states have had consistently low rates of income growth combined with annual tax increases. In particular, Arizona and Connecticut have experienced growth in tax revenues since 1988 on the order of 8 percent annually, while income growth has lagged behind at 4.5 to 5 percent. California, Connecticut, Delaware, and Rhode Island all enacted major tax increases in 1991, and are likely to remain in the top ten list in years to come.

The Low-Tax States

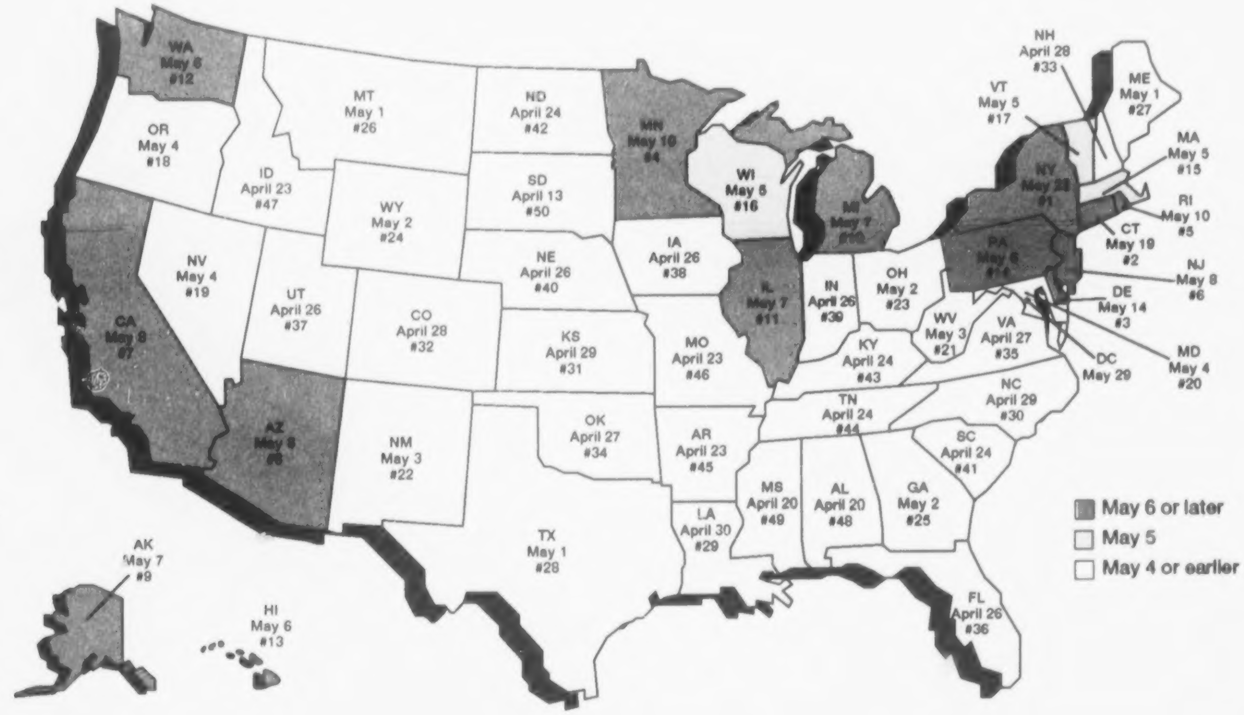
On the low-tax end, the residents of South Dakota and 9 other states, most of them in the Southeast, are all able to pay off the tax collectors by April 24 — eleven or more days earlier than the national average.

TAX FREEDOM DAY

Dan Witt explains the disparity in Tax Freedom Days from state to state.

See State Tax Freedom Days on page 7

Tax Freedom Day by State
Calendar 1992


WA
May 6
#12
OR
May 4
#18
CA
May 8
#7
NV
May 4
#19
ID
April 23
#47
MT
May 1
#26
WY
May 2
#24
UT
April 26
#37
AZ
May 8
#8
CO
April 28
#32
NM
May 3
#22
ND
April 24
#42
SD
April 13
#50
NE
April 26
#40
KS
April 29
#31
OK
April 27
#34
TX
May 1
#28
MN
May 10
#4
IA
April 26
#38
MO
April 23
#46
AR
April 23
#45
LA
April 30
#29
WI
May 5
#16
IL
May 7
#11
MI
May 7
#10
IN
April 26
#39
OH
May 2
#23
KY
April 24
#43
TN
April 24
#44
MS
April 20
#49
AL
April 20
#48
GA
May 2
#25
FL
April 26
#36
SC
April 24
#41
NC
April 29
#30
VA
April 27
#35
WV
May 3
#21
PA
May 6
#14
NY
May 23
#1
VT
May 5
#17
NH
April 28
#33
ME
May 1
#27
MA
May 5
#15
RI
May 10
#5
CT
May 19
#2
NJ
May 8
#6
DE
May 14
#3
MD
May 4
#20
DC
May 29
AK
May 7
#9
HI
May 6
#13
▨ May 6 or later
☐ May 5
☐ May 4 or earlier

Source: Tax Foundation

State Tax Freedom Days from page 6

State	Tax Freedom Day	Rank
South Dakota	Apr 13	50
Mississippi	Apr 20	49
Alabama	Apr 20	48
Idaho	Apr 23	47
Missouri	Apr 23	46
Arkansas	Apr 23	45
Tennessee	Apr 24	44
Kentucky	Apr 24	43
North Dakota	Apr 24	42
South Carolina	Apr 24	41

See map and table below for more details. ■

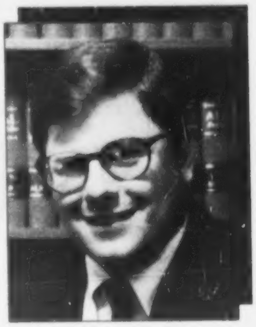
Tax Freedom Day by State Calendar Years 1991-1992

	Tax Freedom Day 1991	Tax Freedom Day 1992	Change from 1991 to 1992
U.S. Total	May 2	May 5	3
Alabama	Apr 19	Apr 20	1
Alaska	May 6	May 7	1
Arizona	May 5	May 8	3
Arkansas	Apr 20	Apr 23	3
California	May 3	May 8	5
Colorado	Apr 28	Apr 28	0
Connecticut	May 12	May 19	7
Delaware	May 12	May 14	2
Florida	Apr 27	Apr 26	-1
Georgia	Apr 30	May 2	2
Hawaii	May 7	May 6	-1
Idaho	Apr 23	Apr 23	0
Illinois	May 4	May 7	3
Indiana	Apr 25	Apr 26	1
Iowa	Apr 27	Apr 26	-1
Kansas	Apr 29	Apr 29	0
Kentucky	Apr 23	Apr 24	1
Louisiana	Apr 28	Apr 30	2
Maine	Apr 27	May 1	4
Maryland	May 3	May 4	1
Massachusetts	May 3	May 5	2
Michigan	May 6	May 7	1
Minnesota	May 8	May 10	2
Mississippi	Apr 19	Apr 20	1
Missouri	Apr 22	Apr 23	1
Montana	May 1	May 1	0
Nebraska	Apr 26	Apr 26	0
Nevada	May 2	May 4	2
New Hampshire	Apr 24	Apr 28	4
New Jersey	May 6	May 8	2
New Mexico	May 2	May 3	1
New York	May 20	May 23	3
North Carolina	Apr 27	Apr 29	2
North Dakota	Apr 25	Apr 24	-1
Ohio	May 1	May 2	1
Oklahoma	Apr 26	Apr 27	1
Oregon	May 4	May 4	0
Pennsylvania	Apr 30	May 6	6
Rhode Island	May 6	May 10	4
South Carolina	Apr 24	Apr 24	0
South Dakota	Apr 16	Apr 13	-3
Tennessee	Apr 23	Apr 24	1
Texas	Apr 29	May 1	2
Utah	Apr 26	Apr 26	0
Vermont	May 2	May 5	3
Virginia	Apr 26	Apr 27	1
Washington	May 6	May 6	0
West Virginia	Apr 30	May 3	3
Wisconsin	May 4	May 5	1
Wyoming	May 3	May 2	-1
Exhibit: DC	May 20	May 29	9

Source: Tax Foundation

FOUNDATION MESSAGE

Tax Freedom Day – A Day to Celebrate After a Long Wait



Dan Witt
Executive Director

April 15th is the date Americans dread, and rightly so, as a day of reckoning when they wave a final farewell to all the tax money withheld from them the year before. Tax Freedom Day, which falls on May 5th this year — the latest date ever, is the Tax Foundation's attempt to give American taxpayers something to celebrate, and something to contemplate as well.

To celebrate for the obvious reason that government is finally paid off. All the money earned from Tax Freedom Day to the end of year can be thought of as duty-free (that is, if you've actually put aside every penny you've earned since January 1 to pay your taxes!).

Tax Freedom Day is a day to contemplate as well because it doesn't actually come every 365 days like the dreaded April 15th. The trend of higher and higher taxes has forced Tax Freedom Day later and later in the year, so that each year, we have a little longer than a year to wait.

For most Americans, income taxes at both the state and federal levels contribute the most to the long wait for Tax Freedom Day. Nationwide, income taxes take the average American over 6 weeks to pay. This year, the burden of income taxes is especially heavy in Connecticut, where a new broad-based 4.5 percent income tax was passed, and in Pennsylvania where the flat rate was raised from 2.1 percent to 3.1 percent.

While wage earners are reminded of their income and Social Security tax burdens on every paystub, what many taxpayers may not realize is how much they routinely pay in sales and excise taxes. Among the six states which hiked sales taxes for 1992, California led the pack by raising its rate from 4.75 percent to 6 percent. Cigarette taxes went from 13¢ to 31¢ per pack in Pennsylvania and from 13¢ to 30¢ in the District of Columbia, while the tax on alcoholic beverages went up in California and North Carolina. The extra nickels and dimes that consumers pay when buying a six-pack of beer, a pack of cigarettes, or any other product really do add up. Consumers will pay more than two weeks' worth of their annual pay in 1992 for these day-to-day taxes [see page 4].

While Tax Freedom Day provides an overall measure of the tax load on U.S. citizens nationwide, the actual burden that individuals must bear is determined to a large extent by the tax and economic climates in their own states and localities. To bring Tax Freedom Day closer to home, the Tax Foundation expanded its Tax Freedom Day study in 1990 to include the specific Tax Freedom Days for each state and the District of Columbia.

For 1992, New York maintains the unenviable position of having the latest Tax Freedom Day in the country. Its taxpayers will work until May 23rd before their tax bills are satisfied, 3 days later than in 1991 and 18 days later than the national average. Connecticut has the second-highest tax burden — taxpayers there will work until May 19th, and Delaware's taxpayers will celebrate Tax Freedom Day on May 14th.

On the low-tax end, the residents of South Dakota and 9 other states, most of them in the Southeast, are all able to pay off the tax collectors by April 24 — eleven days earlier than the national average. Taxpayers in South Dakota will begin working for themselves a full 40 days earlier than New Yorkers, demonstrating that the differences in levels of taxation that prevail across the nation is dramatic.

Although the average American will work until May 5 to pay his tax bill, forfeiting over 34 percent of his income in 1992, the government will spend all that money and more. Tax Freedom Day does not reflect the estimated $400 billion in federal deficit spending for 1992. That will be felt through future tax increases and debt payments. Neither can the taxpayer look to the states with much hope for relief — most states have been responding to recessionary revenue levels by raising taxes, so there is little hope for an earlier Tax Freedom Day in the near future.

Foundation Holds Seminar to Analyze Connecticut Tax Policy

Connecticut's fiscal crisis and the state's prospects for long-term growth were the subject of a Tax Foundation seminar in Stamford, Connecticut on March 31. Cosponsors included the Southwestern Area Commerce & Industry Association of Connecticut, Inc. (SACIA); American Brands, Inc.; the Connecticut Policy & Economic Council; and the Connecticut Business & Industry Association (CBIA).

The speakers were: Edward J. Deak, Ph.D., Chairman, Department of Economics, Fairfield University; William J. Cibes, Jr., Secretary, Connecticut Executive Office of Policy and Management; Senator John B. Larson (D); President Pro Tempore, Connecticut General Assembly; Senator William H. Nickerson (R), Connecticut General Assembly; Eugene C. Gavin, Director of State & Local Taxes, Coopers & Lybrand; Nicholas S. Perna, Senior Vice President & Chief Economist, Connecticut National Bank; John Carson, President, Connecticut Policy & Economic Council; Christopher Bruhl, SACIA; Richard W. Genetelli, President, Genetelli & Associates; and Robert G. Gilbertson, Chairman, Special Projects, Data Switch Corporation.

The Foundation is sponsoring state tax policy programs around the country to share its findings with other states.

◀ ***From left: Dan Witt, Executive Director, Tax Foundation; Edward J. Deak, Ph.D., Chairman, Department of Economics, Fairfield University; Robert G. Gilbertson, Chairman, Special Projects, Data Switch Corporation; Paul Merski, Director of Fiscal Affairs, Tax Foundation; and Nicholas S. Perna, Senior Vice President & Chief Economist, Connecticut National Bank.***

Robert G. Gilbertson, Chairman, Special Projects, Data Switch Corporation, speaks with Chris Bruhl of SACIA.

TAX
FOUNDATION

William J. Cibes, Jr., Secretary, Connecticut Executive Office of Policy and Management.

Tax Features

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Tax Features

TAX FOUNDATION

IN THIS ISSUE

Senate Finance Testimony 1
"Front Burner" 1
California Tax Policy 3
Survey of State Tax Prospects 4
Federal Tax Burden by State 6
Foundation Message 7
Visiting Professors 8

Senate Finance Committee Hears Foundation Testimony On Amortization of Intangibles

Williams Urges Simplification

On April 28, 1992, Tax Foundation chief tax counsel Floyd L. Williams, III, urged the Senate Finance Committee to simplify the tax code's treatment of intangibles. In oral testimony requested by the Committee, Williams presented the Foundation's view that the tax code's current treatment of intangible assets is overly complex and needs revamping.

Left unchanged, the current treatment of intangibles will continue to be the source of significant controversies between taxpayers and the IRS.

Williams called the tax treatment of intangible assets, such as subscription lists, "goodwill," and "going concern" value, acquired in business purchases "a complex issue, which ... left unchanged, will continue to be the source of significant controversies between taxpayers and the IRS."

Many of the controversies of present law could be eliminated through the specification of a single method and period for recovering the cost of most acquired intangible assets.

See Intangibles on page 7

FRONT BURNER

Remove Tax Barriers to U.S.-Owned Businesses in Europe

Senator Daniel Patrick Moynihan

Legislation that I have introduced in this Congress, the "European Community Competitiveness Tax Act of 1991," (S.1653) would amend the tax law to allow U.S. businesses a better opportunity to organize efficiently and compete effectively in the single European Community (EC) market. U.S. companies would be provided a greater opportunity to consolidate their EC activities, streamline their operations, and reduce their costs. In general, my bill would modify the subpart F rules of foreign taxation to enhance the ability of U.S. businesses to market their products in the EC on terms more comparable to their foreign competitors.

We have all been concerned, recently, with the difficulties U.S. businesses have had in competing in the world marketplace. Certainly, many factors besides tax policy are responsible, yet it is vital for us to modify our tax laws when we identify unnecessary restrictions on U.S. businesses competing in the international markets.

The EC member nations have been making steady progress toward a unified single market. As tax and trade barriers between these nations are removed, EC and other foreign-based companies are better able to centralize their businesses in one country and sell their products throughout the EC. By contrast, the U.S. subpart F rules require U.S. multinational companies either to operate separate subsidiaries in each EC country, with resulting duplication of operations and increased costs, or to risk immediate

See Moynihan on page 2

Daniel Patrick Moynihan, a Democrat, is the senior U.S. Senator from New York. He is a Member of the Senate Committee on Finance and Chairman of its Subcommittee on Social Security and Family Policy.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Moynihan from page 1

U.S. taxation on earnings and profits before those earnings are repatriated to the U.S. parent company.

These subpart F rules therefore create a Hobson's choice for U.S. multinationals—they may either forfeit the deferral of tax normally accorded unrepatriated foreign profits, or, to preserve deferral, they must create separate subsidiaries in each foreign country in which their product is marketed, thereby increasing their costs and the price of their products. Under either scenario, U.S. businesses are at a disadvantage in relation to their foreign competitors. Maintaining separate subsidiaries in each EC country is not only contrary to sound business practices, it is manifestly inconsistent with the direction of the economic, tax and trade policies of the new EC single market.

It is vital for us to modify our tax laws when we identify unnecessary restrictions on U.S. businesses competing in the international markets.

The subpart F rules, which were enacted during the Kennedy Administration, were designed to prevent U.S. companies from establishing subsidiaries in low-tax or no-tax countries—tax havens—in order to avoid U.S. taxation on earnings. They can come into play whenever a U.S. company routes foreign sales or services income through intermediate foreign subsidiaries—specifically, whenever a subsidiary of a U.S. corporation in one foreign country makes a sale to, or provides services for, an entity located in a different foreign country. If income is deemed subpart F income, the U.S. parent corporation must pay current tax on it, whereas, normally, foreign earnings are not taxed until repatriated.

Since the rationale for the subpart F rules is to discourage the use of foreign subsidiaries in low-tax, tax-haven countries for tax avoidance purposes, Congress has always provided an exception from their application for foreign subsidiaries in high- or full-tax countries. Prior to the Tax Reform Act of 1986, this "high-tax" exception was determined according to a subjective test. The Tax Reform Act imposed an objective standard under which foreign subsidiaries are not subject to subpart F taxation if they pay taxes in the foreign country at an effective rate that is at least 90 percent of the U.S. effective tax rate, based on U.S. earnings and profits principles.

The high-tax exception, which is intended to provide relief in appropriate cases from subpart F taxation, can often be too restrictive, however. It does not always effectively exempt U.S. foreign subsidiaries that are located in non-tax-haven, full-tax countries. This problem is particularly evident in the EC, where member countries generally are recognized as full-tax countries. U.S. corporate subsidiaries located in the EC have often been unable to satisfy the high-tax test, due to certain timing differences between the U.S. and foreign tax law, and due to the subpart F requirement that the computation of the high-tax exception be made utilizing depreciation schedules that are more restrictive than are available generally under foreign tax law or, indeed, under U.S. tax law for U.S. companies operating domestically.

One approach to remedying this problem would be simply to treat the EC as a single country for purposes of the subpart F rules. Under this rule, a U.S. multinational corporation could consolidate its operations into a single EC subsidiary and market its products throughout the single market without being subject to the subpart F rules. This approach ultimately may prove to be the simplest and most efficient means of allowing U.S. companies fair opportunity to compete in the EC. It deserves further consideration. Some have expressed concern, however, that the EC should make more progress toward complete removal of its own tax and trade barriers before being treated as a single country under our foreign tax rules.

These subpart F rules create a Hobson's choice for U.S. multinationals—they may either forfeit the deferral of tax normally accorded unrepatriated foreign profits, or, to preserve deferral, they must create separate subsidiaries in each foreign country in which their product is marketed, thereby increasing their costs and the price of their products.

This legislation would modify the high-tax exception threshold by lowering it from 90 percent to 80 percent.

I am concerned that too much delay over a solution to this tax problem will cost our companies valuable time as they strive to compete in a rapidly changing environment. In light of that fact, my legislation would, as an interim measure, make the subpart F rules more flexible as they relate to sales and services income of U.S. foreign subsidiaries located, and operating, in the EC. The bill would not, however, provide an opportunity for tax avoidance by U.S. subsidiaries in the EC. This legislation would modify the high-tax exception threshold by lowering it from 90 percent to 80 percent—that is, U.S. companies' foreign subsidiaries paying taxes in the foreign country at an effective rate that is at least 80 percent of the U.S. effective rate would not be subject to subpart F taxation. Further, the legislation provides that the 80 percent foreign effective rate would be calculated without regard to any net operating losses or other similar timing differences incurred prior to the date of enactment. If we made the high-tax exception test more liberal, U.S. multinationals could make necessary business decisions and centralize operations within the EC with greater certainty that they would not be subject to subpart F taxation.

We must make certain that our businesses are not placed at a competitive disadvantage due to unnecessary or overly restrictive U.S. tax laws. Amending the subpart F rules to allow U.S. multinational corporations to reduce their operating costs, without tax penalty, in order to compete more effectively would be an important step toward improving our competitive position in the emerging EC single market. ■

Foundation Holds Seminar on California State Tax Policy

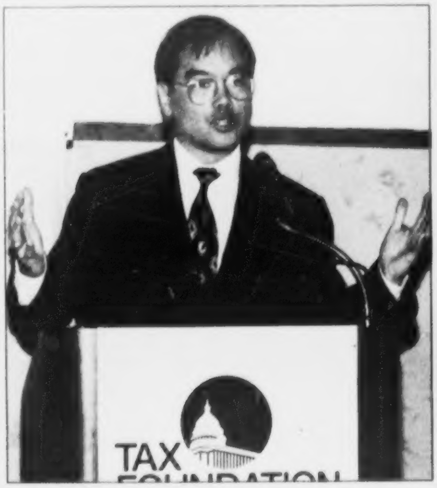
Keynote speaker James C. Miller III, Co-Chairman of the Tax Foundation and former President Ronald Reagan's Director of the Office of Management and Budget from 1985-1988.

"California Fiscal Policy: Creating a Competitive Climate" was the theme of the Foundation's most recent state tax policy seminar. Held in Los Angeles on May 8, the event was kicked off by James C. Miller III, who put California's fiscal woes in a national context.

The state has been suffering from minimal income growth, a sluggish retail industry, and an unemployment rate over eight percent. In spite of the $6.6 billion in additional revenue from last year's tax increases in sales, individual income, and gasoline, the state anticipates a $1.3 billion budget deficit. For FY'93, legislators plan to combat the deficit with a series of revenue provisions.

The two panels of fiscal experts from California's public and private sectors followed the introduction with detailed analysis of these issues. At the luncheon, Donna Tuttle discussed a study newly released by the Council on California Competitiveness. ■

Luncheon speaker Donna Tuttle, President of Korn Tuttle Capital Group, Inc., and a member of the Council on California Competitiveness.



Matthew K. Fong, panelist who serves on the California State Board of Equalization.

From left: Robert W. Poole, Jr., President, Reason Foundation; Larry McCarthy, President, California Taxpayers Association; Paul Merski, Director of Fiscal Affairs, Tax Foundation; and Robert Wycoff, President & Chief Operating Officer, ARCO, and chairman of the California Business Roundtable.

From left: Barry Weissman, Tax Counsel, ARCO; Matthew Fong, Member, State Board of Equalization; Dan Witt, Executive Director, Tax Foundation; Ernest Dronenburg, Chairman, State Board of Equalization; Paul Merski, Director of Fiscal Affairs, Tax Foundation; Robert Ebel, Director of State and Local Services, KPMG Peat Marwick; and Gerald Goldberg, Executive Officer, California Franchise Tax Board.

New Survey Shows States Plan to Raise FY1993 Taxes in Response to Lower-Than-Expected Revenue

A new Tax Foundation survey of the 50 states reveals that new taxes in excess of $7.9 billion have been enacted or proposed for fiscal year 1993. After record tax increases of $17 billion in fiscal year 1992 and $10.3 billion in fiscal year 1991, the proposed FY'93 revenues will be the third largest increase since 1984. Three states, New York, Florida and Maryland, account for more than half of the total increase. New York has the largest tax increase on the drawing board — a plan to extract $1.6 billion in new revenue from a variety of measures, such as extending sunsetting provisions and increasing fees. Florida is contemplating $1.5 billion in new revenue, mostly from sales and business taxes. Maryland taxpayers, still adjusting to $90.1 million in new taxes from FY'92, are preparing themselves for a hit almost ten times as large, $875 million enacted in April of this year. (See tables for detail.)

Table 1
Proposed Fiscal 1993 Net Tax Increases by Major Type of Tax

($Millions)

Tax	Net Amount
Personal Income	$1,088.9
Business	880.5
Sales and Use	1,437.9
Motor Fuels	494.2
Tobacco	467.6
Alcohol	273.7
Property	13.0
Miscellaneous	2,780.4
Total (a)	$7,939.2

(a) Note: total includes $503 million in revenue ($500 million for Alabama and $3 million for W. Virginia) that is a combination of personal income, business, and miscellaneous taxes.

Source: Tax Foundation.

Two symptoms of the nationwide recession, low personal income growth and sluggish personal consumption, continue to make a mockery of state revenue estimates. After last year's substantial increases in individual and corporate income taxes and sales taxes, lawmakers are resorting to a variety of inventive revenue-raising measures: subjecting previously exempt items to sales tax, increasing existing fees and imposing new fees on new products and services, extending temporary tax increases, deferring tax relief legislation, accelerating tax collections, and strengthening audit and administrative enforcement activities. All told, lawmakers will add another $7.9 billion to state coffers, totaling a record $35.2 billion in new revenues in the past three years, $12.2 billion more than was added in the entire decade of the 1980s.

A tax on video poker in Louisiana, a bigger lottery take in Texas, a new pollutants tax in Florida, doubled DUI fines in Georgia — these new taxes and fees, along with accounting changes, comprise the category known as "miscellaneous taxes" and make up more than $2.8 billion of the newly proposed revenue. Spending more on audits is also included in this category and is on the rise as a way to raise revenue; in fact, New York projects a whopping $165 million in new revenue from more vigilant collection efforts. By raising such prodigious sums from such obscure sources, states show how desperate they are to simultaneously raise revenue but avoid the ire of taxpayers that would be roused by higher income and sales taxes.

Nevertheless, three states — Iowa, Mississippi, and Tennessee — are planning to bring in nearly $1.1 billion by raising sales tax rates, and sales taxes are second only to miscellaneous taxes as state revenue-raisers this year. But far more common than rate-raising is base broadening, that is, subjecting more products and services to the current sales tax rate. Florida, Louisiana, Maryland, Minnesota, Ohio, Rhode Island, South Carolina, Virginia, and Washington, D.C. have proposed broadening their sales tax bases to include items such as 1-900 numbers, cable TV, snack foods, and various sewage and solid waste services. All told, this base broadening will garner over $952 million in new FY'93 revenue.

New Jersey is bucking the trend by cutting its projected sales tax revenue by $605 million. Just two years ago, the state raised the rate to its current 7 percent level but is now looking to return the rate to 6 percent in an effort to remain economically competitive with surrounding states.

Eight states are contemplating changes in personal income taxes, with New York and Maryland passing the largest increases. New York extended its temporary increase in the top income tax rate and froze standard deductions at 1991 levels to raise $730 million. Maryland raised its top rate from 5 to 6 percent, increasing revenues by nearly $100 million. Colorado is also contemplating increasing its personal income tax rate from 5 to 6 percent for a $340 million boost in revenue. Arizona and Massachusetts are the only states considering income tax reductions.

Maryland taxpayers, still adjusting to $90.1 million in new taxes from FY'92, are preparing themselves for a hit almost ten times as large, $875 million enacted in April of this year.

Corporations may also feel the pinch of new taxes as states contemplate siphoning $880 million in additional revenues. Business may see increases in income taxes, filing fees, intangibles taxes, and changes in tax payment methods. Businesses in Massachusetts may see a hike in their unemployment compensation costs for employees. In New York, the 15 percent business tax surcharge scheduled to drop to 10 percent was extended for the next two years.

Finally, states will resort to various excise taxes on motor fuels, tobacco, and cigarettes to raise another $1.2 billion in new taxes for FY'93. Taxpayers may feel the heaviest blow from higher motor fuels taxes that will yield a potential $494 million increase. And eight states and the District of Columbia have enacted or planned increases in cigarette excises to raise $468 million in new revenues. ■

Table 2
Fiscal 1993 State Revenue Proposals by Type of Revenue and Net Increase or Decrease [a]

($Millions)

State	Personal Income Taxes	Business Taxes	Sales and Use Taxes	Motor Fuels Taxes	Tobacco Taxes	Alcohol Taxes	Property Taxes	Miscellaneous Taxes	Total Net Revenue
Alabama •	•	•						•	500.0
Alaska									
Arizona	(60.0)								(60.0)
Arkansas									
California									
Colorado	340.0								340.0
Connecticut									
Delaware									
Florida •		269.4	694.4	163.2	2.0	8.5		327.4	1,464.9
Georgia								233.0	233.0
Hawaii								(4.0)	(4.0)
Idaho							6.6		6.6
Illinois					10.0	82.0			92.0
Indiana									
Iowa			274.0						274.0
Kansas									
Kentucky	5.0								5.0
Louisiana •	15.0		325.0					426.6	766.6
Maine									
Maryland •	99.9	6.5	120.1	218.7	89.0			432.6	966.8
Massachusetts	(140.0)	260.0							120.0
Michigan					200.0	147.0			347.0
Minnesota			65.0		21.2				86.2
Mississippi	10.0		166.0						176.0
Missouri	55.0	40.0		64.0					159.0
Montana	34.0								34.0
Nebraska									
Nevada									
New Hampshire									
New Jersey			(605.0)						(605.0)
New Mexico									
New York	730.0	294.0		45.0				494.0	1,563.0
North Carolina									
North Dakota									
Ohio			57.1		97.0	33.3		12.0	199.4
Oklahoma									
Oregon									
Pennsylvania								60.0	60.0
Rhode Island		10.6	46.8					14.8	72.2
South Carolina			1.0					11.2	12.2
South Dakota					4.9				4.9
Tennessee			230.0					190.0	420.0
Texas •								462.0	462.0
Utah									
Vermont									
Virginia			28.9					70.1	99.0
Washington									
West Virginia •	•	•	(1.0)					11.1	13.1
Wisconsin					39.0				39.0
Wyoming									
Dist. of Columbia			35.6	3.3	4.5	2.9	6.4	39.6	92.3
Totals	$1,088.9	$880.5	$1,437.9	$494.2	$467.6	$273.7	$13.0	$2,780.4	$7,939.2

(a) No surveys were received from Arkansas and the District of Columbia.

Alabama - Revenue package includes changes to personal income tax, corporate income tax, and other miscellaneous excises.

Florida - Revenue estimates based on Governor Chiles' proposal. Other proposals include House Finance package estimated at $1,139.9 million and Senate Finance package estimated at $481.9 million. Includes pollutant tax, estimated to raise $163 million in motor fuels revenue.

Louisiana - Miscellaneous taxes comprised of fees for pharmacy costs, physcian costs, nursing homes, and insurance, tax on video poker, and refinancing of debt service payment.

Maryland - Includes one-time windfall gains, as well as all potential increases from local piggyback increases.

Massachusetts - Revenue estimate for business taxes based on calendar year 1992.

Texas - Revenue based on proceeds from state lottery approved on November 1991 ballot.

Virginia - Estimates are based on half of proposed revenue increases since current legislation estimates revenues on biennium budget (1992-94), totaling $197.9 million. Governor Wilder proposes similar legislation which would result in $123.7 million new revenues for the biennium.

West Viginia - $3 million of revenue relates to legislative bill changing the administration and collection of personal and corporate income taxes. Miscellaneous taxes include licenses for super bingo games and insurance premium tax on fire and casualty premiums.

Source: Tax Foundation. Data compiled from state survey of revenue departments, legislative officials, and governors' offices.

Study Shows Each State's Share of Rising Federal Tax Burden

A new study by the Tax Foundation puts the federal tax burden at a record $1,049 billion in fiscal year 1992, or $4,114 for every person in the United States. Titled *The 1992 Federal Tax Burden by State,* this detailed analysis of the Fiscal Year 1993 Federal Budget anticipates the 1993 burden reaching $1,143 billion, a sharp 9-percent increase over the 1992 take. Much of this increased tax burden can be attributed to the Omnibus Budget Reconciliation Act of 1990 (OBRA'90), which is estimated to bring in an additional $164 billion over five years (FY'91–FY'95).

The State-by-State Picture

Californians, as residents of the most populous state in the Union, bear the heaviest burden of federal taxes by a large margin, contributing over $140 billion to finance the federal government, or 13.4 percent of all taxes collected.

But by taking into account the states' populations, we get a different picture of which states' residents bear the heaviest load. Per capita, Connecticut ranks as the most heavily taxed state, with each resident paying $6,243 in federal taxes during 1992. Five other states will exceed $5,000 — New Jersey, Delaware, Alaska, New York, and Massachusetts. These same high-tax states have witnessed an $80 average increase per person in federal taxes from 1991 to 1992. The following ten states ranked the highest in taxes per capita in 1992:

1) CT	$6,243	6) NY	$5,041
2) NJ	5,920	7) MA	5,024
3) DC	5,365	8) MD	4,842
4) DE	5,129	9) IL	4,776
5) AK	5,111	10) NH	4,463

By contrast, taxpayers in the ten lowest per capita tax states paid an average of $2,966 in 1992. The dramatic difference among states can be seen when comparing the citizens of Mississippi, who paid $2,499, to those of Connecticut, who paid almost two and a half times as much in federal taxes. The ten states with the smallest per capita burdens are shown below:

51) MS	$2,499	46) LA	$3,087
50) UT	2,787	45) SC	3,115
49) WV	2,883	44) AL	3,116
48) NM	2,925	43) KY	3,126
47) AR	2,925	42) ID	3,146

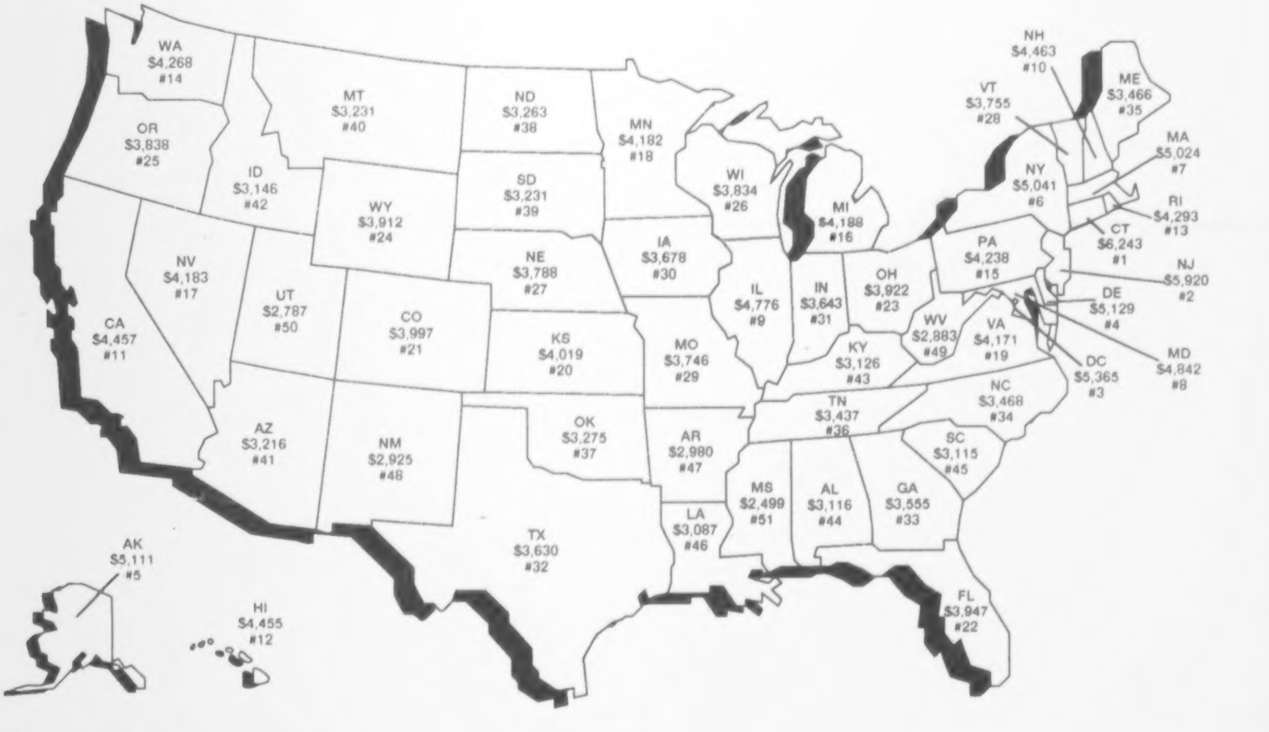
Per capita tax burdens for all states, and their rankings for the current year (FY'92) are shown in the map below.

Tax Burden Outlook

As estimates for 1993 indicate, tax burdens can be expected to rise significantly due to a combination of the tax increases enacted under OBRA'90 and modest economic growth. Without significant reductions in projected federal deficit spending of well over $300 billion for the next several years, additional pressures to raise taxes will mount. These factors do not augur well for the possibility of a decline in the federal tax burden in the near future. ■

Per Capita Federal Tax Burden by State

Fiscal Year 1992


WA $4,268 #14
OR $3,838 #25
CA $4,457 #11
NV $4,183 #17
ID $3,146 #42
MT $3,231 #40
WY $3,912 #24
UT $2,787 #50
AZ $3,216 #41
CO $3,997 #21
NM $2,925 #48
ND $3,263 #38
SD $3,231 #39
NE $3,788 #27
KS $4,019 #20
OK $3,275 #37
TX $3,630 #32
MN $4,182 #18
IA $3,678 #30
MO $3,746 #29
AR $2,980 #47
LA $3,087 #46
WI $3,834 #26
IL $4,776 #9
MI $4,188 #16
IN $3,643 #31
OH $3,922 #23
KY $3,126 #43
TN $3,437 #36
MS $2,499 #51
AL $3,116 #44
GA $3,555 #33
FL $3,947 #22
SC $3,115 #45
NC $3,468 #34
VA $4,171 #19
WV $2,883 #49
PA $4,238 #15
NY $5,041 #6
VT $3,755 #28
NH $4,463 #10
ME $3,466 #35
MA $5,024 #7
RI $4,293 #13
CT $6,243 #1
NJ $5,920 #2
DE $5,129 #4
MD $4,842 #8
DC $5,365 #3
AK $5,111 #5
HI $4,455 #12

Source: Tax Foundation

Intangibles from page 1

These controversies generally concern:

(1) Whether an amortizable intangible asset exists;

(2) The portion of the purchase price of a business that can be allocated to such assets; and

(3) The proper methods and periods for recovering costs of such assets.

A principal trouble with these disputes between taxpayers and the IRS, according to Williams, is that, "They often result in different treatment of similarly situated taxpayers."

Most taxpayers would welcome the certainty and the reduction in IRS audit and legal expenses that would flow from major simplification.

"Many of the controversies of present law could be eliminated through the specification of a single method and period for recovering the cost of most acquired intangible assets," continued Williams, "and by treating acquired goodwill and going concern value as amortizable intangible assets."

Moreover, those taxpayers who currently cannot afford to pursue a controversy through the IRS administrative process or to challenge the IRS in the courts would be treated much more fairly.

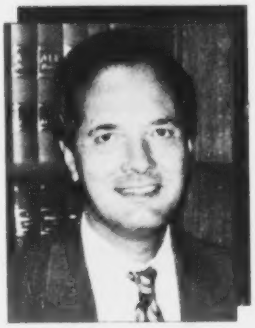
"This is an area of the law where meaningful simplification is within reach," concluded Williams. "Although, as with any tax legislation, there would be winners and losers, in this case most taxpayers would welcome the certainty and the reduction in IRS audit and legal expenses that would flow from major simplification." ■

Upcoming Foundation Events

What	Where	When
Tax & Trade Policy Conference	Washington, DC	June 3
Foundation Policy Council Luncheon	New York City	June 25

FOUNDATION MESSAGE

The Need for Tax Simplification



Floyd L. Williams, III
Chief Tax Counsel

Our testimony before the Senate Committee on Finance last month on the issue of the proper tax treatment of intangible assets acquired in connection with the purchase of a business got me to thinking again about the need for tax simplification. H.R. 4210, the "Tax Fairness and Economic Growth Act of 1992," which was vetoed by President Bush, contained a provision that would have allowed most purchased intangibles (including goodwill and going concern value, which are not currently amortizable) to be amortized over a fourteen-year period, without regard to their actual useful economic lives. The simplification to be achieved would be the result of the elimination of many costly and time-consuming disputes between taxpayers and the IRS over how to allocate the purchase price of a business among the various assets that have been purchased.

Tax simplification also is a goal of the project we have undertaken with Professor Joel Slemrod, of the University of Michigan to study the cost of corporate tax compliance. If we can get a better grasp of the cost components of corporate tax compliance, we can better begin to devise ways to reduce those costs and, thereby, channel more time and effort into productive endeavors. Hopefully, we will also be able to devise a way to judge new legislative proposals in terms of how much they will add to the cost of tax compliance.

Though one might think that tax accountants have the most to gain from having a complex tax system, the Tax Division of the American Institute of Certified Public Accountants (AICPA) recently published an excellent document, titled "Blueprint for Tax Simplification." According to this document, the complexity of our tax law has reached the point where many taxpayers and practitioners believe that it is undermining the tax system. The principal causes for concern are frequent change, the lack of deliberation in the legislative process, and the increasing magnitude and complexity of the Internal Revenue Code. According to the AICPA, the main problems resulting from the existing law's complexity are the inability of taxpayers to understand and comply with the law, taxpayers' perception that the law is unfair, difficulty on the part of the IRS to administer the law, increasing compliance costs, and interference with economic decision making.

The AICPA's Blueprint sets out four elements that will be necessary to achieve a simpler tax system. These are (1) a visible constituency to communicate the need, (2) guiding principles to consider in pursuing tax simplification, (3) recognition of the factors causing complexity, and (4) consideration of simplicity throughout the legislative process.

The AICPA has strongly endorsed tax simplification. When tax accountants are calling for simplification, it is indeed a sign that the system is in trouble. The U.S. Congress should heed that call. A good starting point would be the purchased intangibles legislation contained in H.R. 4210. That bill also contained several other tax simplification measures that ought to be considered seriously.

Our current tax system is nearing the point where it will fall of its own weight if the trend toward complexity is not halted. It is time to reverse that trend and start to draft a tax code that is fair, easily understandable, and does not interfere with economic decision making.

Visiting Professors Chosen for Summer Research Program

After a thorough review of nearly 100 applications, the Tax Foundation has selected two visiting professors for the summer of 1992. The visiting professor program, which is intended to build bridges between the academic community and policy makers, was made possible through generous gifts from the accounting firms of Ernst & Young, and Arthur Andersen & Company.

The Ernst & Young visiting professor will be Patrick J. Wilkie, Assistant Professor of Accounting at the George Mason University School of Business Administration. Joosung Jun, Assistant Professor of Economics at Yale University, will be the Arthur Andersen visiting professor.

Patrick J. Wilkie
Assistant Professor of Accounting
George Mason University School of Business Administration

Professor Wilkie's Ph.D. is from the University of Michigan, as are his graduate and undergraduate degrees. He worked as a tax specialist at Peat Marwick and taught at the University of Michigan and the University of Texas, prior to assuming his current position at George Mason.

He has published many research papers, several of which have appeared in *The Journal of the American Taxation Association*, and he is the recipient of several honors, including an Arthur Young Foundation Grant and a Peat Marwick Main & Co. Fellowship. His most recent research analyzes the methods used by the Congressional Budget Office (CBO) to determine household income and taxes in the development of tax distribution studies.

Joosung Jun
Assistant Professor of Economics
Yale University

Professor Jun received his Ph.D. and graduate degrees from Harvard University; his undergraduate degree is from Seoul National University. Before assuming his present position, he was a faculty research fellow at the National Bureau of Economic Research (NBER), a teaching fellow at Harvard University, and a research assistant to Professor Martin Feldstein. His papers have been published by NBER and the University of Chicago Press.

Professor Jun's research interests include the effects of taxation on capital formation, international aspects of taxation, the real and financial behavior of multinationals, and East Asian economics. Some of his recent work includes studies of taxation's effect on international direct investment, the effects of multinationality on market valuation, and taxation's impact on multinational research and development.

In addition to continuing to pursue their research interests while at the Tax Foundation, Professors Wilkie and Jun will be meeting with tax policy makers in the legislative and executive branches of government, as well as with tax experts in the private sector. ■

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Tax Features

Brady Announces New Treasury Studies at Foundation's Conference On Tax and Trade Policy

On June 3 in Washington, DC, Secretary of the Treasury Nicholas Brady announced at the Tax Foundation's conference on U.S. tax and trade policies that the Treasury would undertake "a comprehensive study of our system of taxing multinational business and investment activities."

Secretary of the Treasury Nicholas Brady speaking at the Foundation's conference on U.S. tax and trade policies.

At the same time, Brady said the Treasury would study the corporate minimum tax "to determine the extent to which that provision is inhibiting the creation, accumulation, and mobility of capital ... and continue to pursue the corporate integration study."

The Foundation conference, titled "The Discord in U.S. Tax and Trade Policies: Prescriptions for Change," opened with a keynote address from Clayton Yeutter, Counsellor to the President for Domestic Policy. Secretary Yeutter spoke broadly about the relationship of federal budget deficits to trade deficits. He pointed out that the merchandise trade deficit has fallen from $170 billion in 1985 to today's $70 billion,

See Tax & Trade on page 3

FRONT BURNER

Wilbur Mills: A Chairman's Chairman

Representative Ray Thornton

Last month, with the death of Wilbur Mills, this country lost one of the greatest Members ever to serve in the United States House of Representatives.

Wilbur Mills was born in Kensett, Arkansas, on May 24, 1909, a town whose welcome sign reads "Kensett, Home of Wilbur Mills." He graduated from Hendrix College and studied law at Harvard University. He was admitted to the Arkansas bar in 1933, and in 1935, at the age of 25, was elected to the position of county and probate judge for White County.

Wilbur Mills was first elected to the U.S. House of Representatives in 1938, and served in 18 successive congresses. He was appointed to the Committee on Ways and Means in 1943, and became its chairman in 1959. His service as chairman spanned more years than any other chairman of that committee, and tax policy during his tenure was marked by a stablility that is sorely lacking now. He oversaw nearly every important piece of domestic legislation, and many far-reaching programs still bear his mark. Moreover, the Tax Reform Act of 1969 was, at that time, the most significant reform effort since enactment of the current federal tax system in 1913. In 1958 and again in 1968, he received the Tax Foundation's Distinguished Service Award, joining Harry F. Byrd, Sr., as the only other person to receive that distinction twice. When Mr. Mills left Congress at the end of 1976, he joined the Washington office of Shea & Gould, where he built a new, successful career as a corporate tax lawyer and consultant.

See Thornton on page 2

Ray Thornton, Democrat from Arkansas, serves on the Government Operations Committee and the Science, Space, and Technology Committee. He is currently in his first term, but served previously from 1973-1979.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

TAX FOUNDATION

IN THIS ISSUE

Tax & Trade Conference 1
"Front Burner" 1
Texas Tax Policy 4
Viewpoint 5
Property Tax Collections by State 6
Foundation Message 7
Delegation Advises Russia on Foreign Investment 8

Front Burner from page 1

It is my privilege now to be serving the second congressional district of Arkansas, which was Chairman Mills' district for many years. However, when I first came to the U.S. House of Representatives, at the beginning of the 93rd Congress in 1973, Wilbur Mills was starting on his 18th term in the House. At that time, Mr. Mills was chairman of both the Committee on Ways and Means and the Committee on Committees. He tried very hard to get an assignment for me on the Committee on Appropriations. Of course, that kind of assignment was unheard of for freshman Members of Congress, so I was not dismayed when he called to suggest that the Committee on the Judiciary would be a nice, quiet place for me to build up some seniority. I still do not know, to this day, whether Chairman Mills knew that the thirty-seven members of that nice, quiet committee would all too soon be charged with the immense responsibility of deliberating the impeachment of the President of the United States. Nevertheless, there was one thing of which I was sure. That is, that he was a true friend who was looking after me.

In describing the place that Chairman Mills has earned in American history, scholars will doubtless note that he was one of the greatest legislative engineers of all time.

On the one hand, Chairman Mills possessed insights into the workings of Washington, D.C., which were unexcelled. On the other, he had a genuine desire to look after the many, many people he counted among his friends. When Mr. Mills was first elected to the U.S. House of Representatives in 1938, one of his advisors, Max Allison, told him to hang up his farmer's cap and wear a hat. Wilbur Mills followed that advice, but he never did abandon his ties to the average citizens and their values. He always stayed close to his Arkansas constituents and would invite them directly into his office regardless of the number of, or power possessed by, the officials who were waiting in his reception room to see him.

In describing the place that Chairman Mills has earned in American history, scholars will doubtless note that he was one of the greatest legislative engineers of all time. They will list his achievements in writing tax and trade law, and they will chalk them up to his remarkable intellectual gifts and to his political wisdom. During his tenure in Congress, he worked with seven Presidents: Franklin Roosevelt, Harry Truman, Dwight Eisenhower, John Kennedy, Lyndon Johnson, Richard Nixon, and Gerald Ford. President Kennedy, whom Mills liked the best, told a massive crowd at the dedication of Greers Ferry Dam in 1962 that when the Chairman told him where to be, he showed up and he made a speech.

In 1958 and again in 1968, he received the Tax Foundation's Distinguished Service Award, joining Harry F. Byrd, Sr., as the only other person to receive that distinction twice.

It is generally well known that Wilbur Mills was legendary for having practically memorized the Internal Revenue Code and knowing all of its intricate parts and how they related to each other. Because of his knowledge of the tax code, Wilbur Mills had great power, and it is often said that, because of his position and power, he was the second most powerful man in America. However, notwithstanding his enormous knowledge of, and influence over, the tax code, he never even itemized his tax deductions nor did he hold any personal business interests that might have benefitted from his legislative activities. Wilbur Mills was the kind of person who put the betterment of the country before his own personal interests and who used his position of power to that end.

He always stayed close to his Arkansas constituents and would invite them directly into his office regardless of the number of, or power possessed by, the officials who were waiting in his reception room to see him.

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If scholars and historians stop after listing Wilbur Mills' legislative achievements, they will fall far short of measuring the man. For all of his stature, for all of his brilliance, and for all of the demands that were made on his time, Chairman Mills never forgot his friends, whether they were heads of state or neighbors that he passed on the streets of Kensett, Arkansas. For me, and countless other people from all walks of life, Chairman Mills was, first and foremost, a thoughtful, caring, and truly gentle man who never forgot his roots.

There are still a few men and women in Congress who share with me the good fortune to have served with Chairman Mills and to have known firsthand what a rare and special man he was. It was a great honor, indeed, to have worked with Chairman Mills, but it was an even greater privilege to have been his friend. ■

Tax & Trade from page 1

and that the $70 billion is balanced by a services trade surplus of approximately the same amount. Yeutter called this trend "immense progress" but noted that "we don't have those capital flows coming in to contribute to the handling of our federal budget deficit as we had before."

Yeutter briefly addressed the place of the value-added tax in the tax and trade debate, pointing out that the GATT rules allow VATs to be rebated. Even this disadvantage of our tax system is only transitory, according to Yeutter "because exchange rates will adjust ... in a relatively short period of time."

At left, Dexter Baker, chairman of Air Products and Chemicals, Inc., chats with Treasury Secretary Nicholas Brady.

Clayton Yeutter, Counsellor to the President for Domestic Policy, answers questions from the press after his speech.

The first panel session of the morning, "The Outlook for Sound Tax and Trade Policies: A View From Congress," featured four Members of Congress who play key roles in formulating tax and trade policy. Senator Max Baucus (D-MT), chairman of the Senate Finance Committee's Subcommittee on International Trade, declared that "the greatest public challenge we face in America today is halting and reversing our country's loss of competitiveness." He sees that as a two-front war: opening markets abroad where anti-competitive trade practices currently prevail, and working at home to improve education, infrastructure, and technology.

Senator John C. Danforth (R-MO), ranking Republican on the Subcommittee on International Trade, sees federal budget deficit reduction as the best trade policy the U.S. can pursue and thinks that deficit reduction must be the primary issue in this election year. He noted that our huge national debt amounts to dissaving and tends to operate as a dead weight on the functioning of our economy and on American competitiveness.

Representatives Sam Gibbons (D-FL), chairman of the House Ways and Means Committee's Subcommittee on Trade, and Richard T. Schulze (R-PA), ranking Republican of the Ways and Means Committee's Subcommittee on Oversight, completed the congressional panel.

Next, four executives discussed the impact of U.S. tax and trade policies on our global competitiveness. The speakers were Onno Ruding, Vice Chairman, Citicorp; James R. Jones, Chairman, American Stock Exchange; Dexter F. Baker, Chairman, Air Products and Chemicals, Inc.; and Timm Crull, Chairman & CEO, Nestlé USA.

"Assessing U.S. Tax and Trade Laws in the Post-Cold War Era" was the theme of the last panel. Tax Foundation Co-Chairman James Q. Riordan, Esq., introduced the subject, then turned it over to Ernest S. Christian, Jr., Esq., Partner, Patton, Boggs & Blow; and Gary Hufbauer, Ph.D., Wallenberg Professor of International Financial Diplomacy, Georgetown University. ■

Tax Foundation Executive Director Dan Witt at left with Treasury Secretary Brady.

From left: Tax Foundation Chief Tax Counsel Floyd L Williams, III, Senator John Danforth (R-MO), and Onno Ruding, vice chairman of Citicorp.

From right, Tax Foundation Co-Chairman James C. Miller III speaks to Senator Max Baucus (D-MT), Tax Foundation Chief Tax Counsel Floyd L Williams, III, and Timm Crull, Chairman & CEO, Nestlé USA.

Foundation Holds Seminar on Texas State Tax Policy

Dallas was the site last May 21 of the Tax Foundation's most recent in a series of seminars examining the impact of state and local fiscal policies on economic growth. Titled "Texas State and Local Tax Policy — Meeting The Economic Challenge," the program was conducted with the cooperation and guidance of the Greater Dallas Chamber of Commerce, the Financial Executives Institute, the Tax Executives Institute, and the Plano Chamber of Commerce.

TAX FOUNDATION

Luncheon speaker W. R. Howell, Chairman of the Board and Chief Executive Officer, J. C. Penney Company, Inc.

Thomas H. Cruikshank, Chairman & Chief Executive Officer, Halliburton Company

John Goodman, president of the Dallas-based National Center for Policy Analysis, kicked off the program by presenting an overview of the nation's fiscal problems, then highlighting fiscal causes of Texas's economic woes.

Three panels of fiscal policy experts from Texas's public and private sectors followed by examining in detail the causes of, and potential cures for, the state's ailing economy. The first session focussed on how tax policies are formulated and the potential fallout of a special legislative session. Jack Skinner, vice president of taxes for Halliburton Co., shared the panel with E. Kenneth Black, state legislative coordinator for Electronic Data Systems Corporation, and William Allaway, executive vice president of the Texas Association of Taxpayers.

James Evatz, manager of ad valorem taxes, J.C. Penney Company, chaired the second session on public school financing. Dr. Jim Surratt, superintendent of the Plano Independent School District debated Dr. Billy D. Walker, executive director of the Texas Association of School Boards over new approaches to improve Texas's education system.

The state budget process and the impact that tax policies have on state economic development were addressed in the third session. Garry Miles moderated a lively discussion with Dr. Bernard Weinstein, director of the Center for Economic Development and Research at the University of North Texas and Jan Hart, Dallas's city manager. A luncheon program followed with participation by two Texas-based chief executive officers — Thomas H. Cruikshank of Halliburton Co. and W.R. Howell of J.C. Penney Company. (See opposite page for a digest of Howell's luncheon address.) ■

Keynote speaker John Goodman, President, National Center for Policy Analysis

From left: Thomas H. Cruikshank, Chairman & Chief Executive Officer, Halliburton Company; Frances Wright, Esq.; Dan Witt, Executive Director, Tax Foundation; W. R. Howell, Chairman of the Board and Chief Executive Officer, J. C. Penney Company, Inc.; Paul G. Merski, Director of Fiscal Affairs, Tax Foundation; and Ron Bunn, Director of Corporate Development, Tax Foundation.

TAX FOUNDATION

James N. Evatz, Manager of Ad Valorem Taxes, J.C. Penney Company, Inc., moderated the second session of the program, which addressed the problems Texas has been experiencing with its financing of public education.

Control of Government Spending Critical to Prosperity for States and Localities

W.R. Howell
Chairman of the Board and Chief Executive Officer
J.C. Penney Company.

In spite of the record tax increases enacted last year, many state legislatures are again facing major budget shortfalls. Twenty-seven states have an aggregate projected shortfall of $5.8 billion for the current fiscal year, which ends this June 30th. This follows two years of tax increases, which exceeded 22 billion dollars.

The electorate has responded both vocally and at the ballot box. They defeated almost all state initiatives that would have increased taxes — plus they enacted state term limitations in California, Colorado, and Oklahoma. Without question, state legislators are getting the message. One constant theme heard throughout all state and local governments is that the philosophy of "business as usual" has ended.

Unfortunately, the federal government continues to put additional fiscal pressure on the states by saddling them with unfunded mandates. This burden has increased substantially in the last several years — and shows no sign of being curtailed in the future. So overall, most states are faced with declining revenues and increased spending.

In addressing the states' financial plight, we must always examine the spending side of the budget equation before considering additional tax revenues. Texas took a strong first step toward bringing spending under control during 1991 when the comptroller conducted performance audits on the various state agencies. These performance audits examined many state government operations and raised tough questions about how our tax dollars are spent.

In addressing the states' financial plight, we must always examine the spending side of the budget equation before considering additional tax revenues. Texas took a strong first step toward bringing spending under control during 1991 when the comptroller conducted performance audits on the various state agencies.

Some changes were made, but this is only a start. Measures must be put into place to restrain the growth in future state government spending. These limitations could include: restricting the growth in spending to the growth rate of the state's economy, as measured by gross state product; and requiring any new programs to specify the revenue source to fund the program or reduce spending on other programs. Reforms such as these must precede any major restructuring of a state's tax system.

State governments must address the needs of their citizens, of course, but they must realize that they cannot be all things to all people. They must focus on what they can afford, and spend their resources on those services deemed to be most critical.

In fact, I believe there's a strong argument for states to hold hearings on the potential impact of living within budgets based solely on current revenue levels. I am sure the citizens of each state would have strong and valid opinions about where their money should be spent.

Let me share with you our opinion of what constitutes good tax policy. First, tax policy must not have a negative impact on economic growth. Dr. Richard Vedder — formerly an economist with the Joint Economic Committee of Congress — has issued a study regarding the impact of state and local taxes on economic growth in Pennsylvania. He concluded, "Economic growth can be measured by looking at the change in real per capital income, or the migration of business capital, or changing employment. Evidence is overwhelming using all three approaches that state and local taxes can and do have an adverse impact on the rate of economic growth." This is a clear warning about the detrimental effect of increased taxes — and should be heeded by every state intent on economic growth.

The federal government continues to put additional fiscal pressure on the states by saddling them with unfunded mandates. This burden has increased substantially in the last several years — and shows no sign of being curtailed in the future.

Second, the tax system must have stability and predictability for planning purposes. And third, the current economic environment does not lend itself to the unknown effects of a major tax overhaul. While some economic indicators are picking up, recovery is slow in coming. Major tax revisions in this transitionary period would be bad policy.

Harrison Salisbury, the Pulitzer prize winning journalist, grew up in the depression in Minnesota and went off to cover World War II. Following the war, he reported from Moscow; he covered Vietnam; he's a recognized authority on developments in China; and he's been a keen observer of America throughout these past 50 years.

Last weekend, I asked him whether he could remember a more uncertain time for our country. He said he could not.

"For my part," he said, "I believe we've lost our center. We have allowed ourselves to be divided into countless competing political, ethnic, economic, and emotional fiefdoms, each concerned only with its place on the turf of reward and recognition. In these fiefdoms, there is only one litmus test of worthiness: Will it serve my interest?"

I believe those words say a lot about where we are today — and why some fundamental changes are so very important to the continued health and prosperity of this country.

In closing, states should make every effort to keep their tax climate favorable to the formation and attraction of business interests — both for the business itself and the individual taxpayers who participate in it. That's the foundation for economic growth — and, indeed, the foundation of America's free enterprise system. ■

Property Tax Collections Reach $150 Billion Nationwide in FY'90

State and local property tax revenues climbed $13.1 billion in fiscal year 1990, a 9.2 percent increase over 1989. The $155.6 billion collected in 1990 from property taxes is over twice the revenue collected a decade earlier, and represents 31 percent of state/local revenues.

Primary Source of Local Revenues

For local governments, property taxes continue to be the primary source of tax revenue. In FY'90, $150 billion in property tax levies provided 74.5 percent of local tax revenue, a 9.2 percent increase over FY'89. In contrast, state governments collected only 2 percent of their tax revenues from property tax levies. Forty-two states levy a property tax, but the insignificance of the collections is explained by the narrow base upon which the tax is imposed.

State/Local Property Tax Collections by State

Per Capita and Per $1,000 of Personal Income

Fiscal Years 1980 and 1990

	Per Capita				Per $1,000 of Personal Income			
	Amount		Percent	Rank	Amount		Percent	Rank
State	1980	1990	Change	1990	1980	1990	Change	1990
Total	$ 302	$ 626	106.9%	-	$ 35	$ 36	.4%	-
Alabama	79	163	107.3	51	12	12	.7	51
Alaska	900	1,246	38.5	1	79	60	-24.0	1
Arizona	352	636	80.7	23	46	41	-10.5	17
Arkansas	134	228	70.9	49	20	17	-14.2	48
California	274	602	119.9	25	28	31	8.8	32
Colorado	329	684	107.8	19	38	39	2.9	23
Connecticut	473	1,056	123.1	5	47	43	-6.9	15
Delaware	167	304	82.3	44	18	16	-11.2	50
Dist. of Col.	344	1,198	248.4	2	32	55	74.2	5
Florida	224	612	172.8	24	29	35	21.3	25
Georgia	199	494	148.2	32	28	31	11.4	31
Hawaii	193	384	99.0	39	22	21	-5.8	42
Idaho	227	414	82.7	37	31	30	-3.9	33
Illinois	367	754	105.5	15	38	39	2.4	21
Indiana	246	472	92.3	34	29	30	2.9	34
Iowa	360	660	83.5	20	41	42	2.0	16
Kansas	366	658	80.1	21	39	39	-1.2	22
Kentucky	135	252	86.2	48	19	18	-5.4	47
Louisiana	111	269	142.2	46	15	20	30.6	45
Maine	319	722	126.0	17	47	45	-3.3	14
Maryland	288	590	104.7	27	31	29	-7.7	37
Massachusetts	555	778	40.1	13	62	36	-42.0	24
Michigan	413	820	98.4	11	44	47	6.2	11
Minnesota	324	709	118.6	18	37	40	8.9	20
Mississippi	141	341	142.6	42	24	29	22.8	38
Missouri	216	342	58.7	41	26	21	-20.3	43
Montana	455	828	82.0	9	59	58	-1.6	3
Nebraska	401	762	90.3	14	46	48	4.3	10
Nevada	256	425	66.1	36	28	24	-13.8	39
New Hampshire	451	1,151	155.5	3	56	57	1.5	4
New Jersey	499	1,149	130.3	4	51	48	-6.1	9
New Mexico	142	219	53.7	50	20	16	-16.3	49
New York	501	1,023	104.3	6	55	49	-11.1	8
North Carolina	171	353	106.5	40	24	23	-3.4	40
North Dakota	269	476	77.0	33	32	34	4.7	26
Ohio	281	516	83.5	30	32	31	-3.5	30
Oklahoma	151	277	83.2	45	19	19	2.7	46
Oregon	382	854	123.4	8	45	54	21.3	6
Pennsylvania	249	516	106.9	31	29	29	0	35
Rhode Island	413	806	94.9	12	50	45	-8.9	13
South Carolina	160	401	151.6	38	24	29	21.5	36
South Dakota	351	583	66.1	29	47	41	-12.0	19
Tennessee	158	321	103.9	43	22	22	-4.0	41
Texas	280	651	132.7	22	34	41	22.5	18
Utah	235	432	83.9	35	35	33	-4.4	28
Vermont	377	822	118.3	10	53	50	-6.4	7
Virginia	236	598	153.6	26	28	32	13.5	29
Washington	290	584	101.0	28	32	34	5.9	27
West Virginia	137	256	87.4	47	19	20	4.0	44
Wisconsin	361	738	104.7	16	42	45	6.5	12
Wyoming	552	901	63.3	7	58	59	2.1	2

Source: Department of Commerce: and Tax Foundation computations.

Growth Rates Per Capita and Per $1,000 of Personal Income

Property tax revenue has risen nearly 127 percent over the past decade, from $68.5 billion to $155 billion. Per capita growth has been only slightly less dramatic, rising 107 percent, from $302 in 1980 to $626 in 1990. Relative to personal income, property tax revenue per $1,000 of income has risen slightly, from $35 to $36.

Five states and the District of Columbia now collect over $1,000 per person in property tax revenue. Despite a modest decline in per capita collections from FY'89, Alaska still has the highest per capita burden ($1,246). The other five states with a per capita burden above the $1,000 mark are the ~~District~~ of Columbia ($1,198), New Hampshire ($1,151), New Jersey ($1,149), Connecticut ($1,056), and New York ($1,023). At the other end of the property tax spectrum, the lowest per capita burdens were found in Alabama ($163), New Mexico ($219), Arkansas ($228), Kentucky ($252), and West Virginia ($256). Residents of the states with the highest per capita burdens paid an average of $936 more than those living in states with the lowest per capita burdens.

Property tax growth rates for the decade ranged from a staggering 248.4 percent in the District of Columbia, with Florida in a distant second at 172.8 percent, and New Hampshire placing with a 155 percent per capita growth rate. No state experienced a decline in per capita state/local tax collections from 1980 to 1990.

Property Taxes Per $1,000 of Income

Property tax collections per $1,000 of personal income provide a better yardstick with which to estimate the property tax burden in a given state. Leading the country in this category in 1990 was Alaska ($60), despite a 24 percent decline since 1980. Following close behind are Wyoming ($59), Montana ($58), New Hampshire ($57), and the District of Columbia ($55). States with the lowest property tax burdens in 1990 were Alabama ($12), Delaware ($16), New Mexico ($16), Arkansas ($17), and Kentucky ($18).

From 1980 to 1990, property tax burdens relative to personal income increased in 24 states and the District of Columbia. D.C. had the most drastic increase, 74 percent, from $32 to $55. In contrast, Massachusetts and Louisiana reported declines in their property tax burdens relative to personal income, at 42 percent and 30.6 percent, respectively. (The table at left provides additional detail.) ■

U.S.-European Conference Proceedings Published

The Foundation has published the proceedings of its conference last January, "EC'92 and Its Implications for Global Competitiveness." Informal panel discussions took place with government tax officials and business representatives in the UK, France, Belgium, and Germany.

Congressional tax-writing committee staff and personal staff of committee members attended. Corporate participants were: Brown & Williamson Tobacco, Inc., Glaxo, Inc., Xerox Corporation, BASF Corporation, Citicorp/Citibank, N.A., ITT Corporation, Rhône-Poulenc, Inc., and Nestlé Holdings, Inc.

The proceedings are edited and annotated by Tracy A. Kaye, Assistant Professor of Law, Seton Hall University School of Law, and Research Fellow, Tax Foundation. ■

Recent Foundation Publications

Seminar Proceedings: EC'92 and Its Implications for Global Competitiveness	**24 pp.; $10 + $2 p/h**
Facts and Figures on Government Finance, 1992 Edition	**Cloth; 359 pp.; $55 + $2 p/h**
Special Report: The 1992 Federal Tax Burden by State	**8 pp.; $8 + $2 p/h**
Special Report: 1993 State Fiscal Prospects	**12 pp.; $8 + $2 p/h**
Seminar Proceedings: The Role of Tax Policy in Economic Growth	**47 pp.; $10 + $2 p/h**
Special Report: Tax Freedom Day 1992 is May 5	**8 pp.; $8 + $2 p/h**

FOUNDATION MESSAGE

The Path to Post-Cold War Prosperity

Dan Witt
Executive Director

There is a growing concern that the American economy is not as competitive with foreign nations as it used to be, partly due to conflicting and punitive tax and trade policies. The Foundation's most recent conference in Washington (see page 1) explored those conflicting policies, and offered prescriptions to promote the free flow of goods, services, and capital across international borders, in an attempt to point the way toward more competitive tax and trade policies.

This discussion was especially timely because the end of the Cold War has brought the world's military and economic alignments to a critical juncture. Some Western military relationships are clearly diminishing in importance. Unfortunately, these changes appear to be weakening the mutually beneficial economic relationships that we have enjoyed with our major trading partners since World War II.

Western Europe is increasingly preoccupied with EC'92 and the newly independent nations of Eastern Europe, leading President Bush to raise the specter not too long ago of an "iron curtain of protectionism" descending around Europe. Meanwhile, the war of words continues between U.S. and Japanese politicians over international trade issues.

The United States is the world's leading economic power. Instead of standing on the sidelines, or even worse, contributing to trade frictions, we should lead by example, adopting tax and trade policies that do nothing to stifle commerce. It is reasonable to assume that other countries will follow suit if we make substantial strides in reducing our tax and trade barriers.

EC'92 itself provides a dramatic example of other countries' emulating U.S. success in this area. The move toward a single European market with no internal barriers is a direct consequence of our own free flow of goods, services, capital, and people among states. Europe recognized the economic advantages of a huge market with few internal barriers, and decided to go us one better by forming an even larger market. The prospect of a unified Europe, in turn, gave more impetus to U.S. efforts to forge a North American Free Trade Agreement.

Will such changes accelerate the race toward open markets, or will the world break down into rival trading blocs?

Recent changes in the U.S. tax code have not been helpful in this regard. Trade barriers of a sort have been erected, mostly in the way certain types of income are treated by the tax law. Compared to the tax laws of other industrialized nations, such as Japan, West Germany, and the United Kingdom, U.S. tax law is overly complex and lacks stability because of frequent changes. This puts U.S. multinationals at a competitive disadvantage by making their long-range planning much more costly than it is for their foreign counterparts. Moreover, rigorous recordkeeping requirements imposed on foreign-owned U.S. corporations and an aggressive posture of worldwide jurisdiction on the part of the IRS have been the subject of much argument and have caused justifiable fears of retaliation from foreign governments.

The great public debate over the direction of the world economy rages on, as it has since the demise of Soviet communism. The Tax Foundation will continue to play its role in that debate, providing a forum for discussion of prudent changes in U.S. policy that would promote international trade by reducing tax burdens and lowering trade barriers.

Foundation Delegation To Advise Russian Government on Taxation of Foreign Investment

The Tax Foundation has been invited by Russia's State Committee on Taxation and Ministry of Finance to lead a delegation of noted tax experts to visit Moscow from July 1-7. The group will help develop guidelines for future laws governing the taxation of foreign investment in Russia. On July 7 in Moscow and Washington, a statement will be issued jointly by the delegation and relevant Russian officials, offering recommendations for the resolution of key tax issues in the foreign investment area.

I.A. Lazarev, chairman of the Russian State Tax Committee, issued the invitation to the Tax Foundation through the Foundation of International Cooperation and Development.

The American delegation includes: The Honorable Bill Frenzel, Guest Scholar, Governmental Studies, The Brookings Institution (delegation leader); Dr. Charles C. McLure, Jr., Hoover Institution, Stanford University; Edward Lieberman, Esq., Pepper, Hamilton & Scheetz; Bruce S. Brown, Vice President - Taxes, Philip Morris Companies Inc.; Ken Crawford, Partner, KPMG Peat Marwick; Robert S. Enright, Vice President - Taxes, PepsiCo, Inc.; Richard Gordon, Partner, Arthur Andersen & Co.; David C. Jory, Vice President, Citicorp/Citibank, N.A.; Ian Lee-Leviten, Vice President, Tax Planning & Audit, RJR Nabisco, Inc.; Alan J. Lipner, Senior Vice President - Corporate Taxes, American Express Company; Daniel H. Payne, Vice President - Taxation, BHP Minerals Incorporated; George W. Reardon, Director of Taxes, Archer Daniels Midland Company; James Q. Riordan, Esq.; Jack R. Skinner, Vice President - Taxes, Halliburton Co; and Dan Witt, executive director of the Tax Foundation.

The Russian officials they will meet include: Yegor Gaidar, Acting Prime Minister; A.G. Shapovaliantz, Deputy Minister of Finance; Alexander Pochinok, Chairman, Committee on Budget and Prices, Supreme Soviet of Russia; A.P. Vavilov, First Deputy Minister of Finance; Sergei Filatov, First Deputy Chairman, Supreme Soviet of Russia.

This opportunity for the Foundation to guide the establishment of the Russian tax code has arisen thanks to the Moscow Business Conference, which the Foundation co-sponsored in December 1991. Amidst all the turmoil of that season in Moscow, Foundation members were teaching Russian entrepreneurs the nuts and bolts of the free enterprise system and coaching government officials to avoid overly complex policies that discourage foreign investment. Yegor Gaidar, Acting Prime Minister, and A.G. Shapovaliantz, Deputy Minister of Finance, were both participants in that conference and will play a key role in the success of the upcoming meetings. ■

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Tax Features

Foundation Testimony to Ways & Means Committee Urges Removal of Burdens On Multinational Operations

On July 22, 1992, Floyd L. Williams, Chief Tax Counsel of the Tax Foundation, appeared before the House Committee on Ways and Means, on a panel with representatives from the American Bar Association, Tax Executives Institute, and the National Association of Manufacturers, to present the Foundation's views on H.R. 5270, "The Foreign Income Tax Rationalization and Simplification Act of 1992." That bill contains several provisions that are designed to eliminate excessive burdens placed on U.S. multinational corporations in conducting business abroad and several provisions designed to extract more U.S. tax from foreign-owned businesses conducting business in the U.S. and foreigners holding certain domestic investments.

Tax Foundation Chief Tax Counsel Floyd L. Williams, III presents the Foundation's testimony to the House Ways and Means Committee.

Williams noted, at the outset, that "to some extent the U.S. through its tax policy has placed its own multinational corporations at a disadvantage by imposing more severe restraints and heavier tax burdens on foreign source income than have several of its trading partners. Moreover, the frequent changes in, and complexity of, the tax law can be a disadvantage to our multinationals because of the high cost of tax compliance." Williams further stated that the Tax Foundation believes that "just as U.S. multinationals should not be placed at a disadvantage, U.S. tax policy should not impede

See Ways & Means on page 3

TAX FOUNDATION

IN THIS ISSUE

Ways & Means Testimony 1

"Front Burner" 1

Presidential Candidates' Views 3

Policy Maker Interview 6

Foundation Message 7

Foundation Workshop on Section 482 at NYU 8

FRONT BURNER

Benefits of Possessions Tax Credit Should Be Extended, Not Curtailed

Representative Philip M. Crane

On June 21 and 22, 1992, the House Ways and Means Committee held hearings on H.R. 5270, "The Foreign Income Tax Rationalization and Simplification Act of 1992."

That legislation, which is quite comprehensive, contains several proposals that are designed to assist U.S. multinational corporations in conducting business abroad. However, it also contains some provisions that are not so beneficial to U.S. multinational corporations, as well as provisions designed to increase the taxes of foreign enterprises conducting business in the U.S.

The provision of H.R. 5270 that most concerns me is the proposal to reduce the Puerto Rico and possession tax credit (Internal Revenue Code section 936) from 100 percent to 85 percent of pre-credit U.S. tax on a company's possession-based operations and qualified possession source investment income. Currently, the Puerto Rico and possession tax credit provides a 100-percent tax credit against U.S. income tax for business income and qualified passive investment income earned by certain U.S. corporations operating in U.S. possessions (so-called "section 936 corporations"). The section 936 credit is a deliberate departure from capital export neutrality. Its purpose is to provide an incentive for U.S. corporations to invest in certain U.S. possessions and, thereby, increase employment in those possessions. Most section 936 corporations operate in Puerto Rico. However, the credit is also available with respect to U.S. business operations in the North-

See Crane on page 2

Phil Crane, Republican from Illinois, serves on the House Ways and Means Committee and is the ranking minority member of its Subcommittee on Trade.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Crane from page 1

ern Mariana Islands, Guam, the U.S. Virgin Islands, American Samoa, and the Federal States of Micronesia.

Although section 936 has come under some criticism lately, the operation of the section 936 credit is still the most cost effective and successful way to promote economic development within the U.S. Commonwealth of Puerto Rico. As my friend and colleague, Antonio Colorado, Puerto Rico's resident commissioner, has pointed out, section 936 is critical to the vitality of the Puerto Rican economy, and has helped to create more than 150,000 jobs on the U.S. mainland. He also noted that in 1991, $21.3 billion worth of products exported by Puerto Rico was equal to 65.7 percent of its entire gross domestic product, and that most of these exports were from section 936 manufacturing companies. I am concerned that any adverse changes to section 936 could have rather negative consequences for the Puerto Rican economy.

Although section 936 has come under some criticism lately, the operation of the section 936 credit is still the most cost effective and successful way to promote economic development within the U.S. Commonwealth of Puerto Rico, ... [and it] has helped to create more than 150,000 jobs on the U.S. mainland.

The value of section 936 was recognized as recently as 1986 when the Caribbean nations were granted access to section 936 funds. I believe that allowing the Andean countries of Bolivia, Peru, Columbia, and Ecuador to have access to these same benefits would be an excellent way to stimulate their economies while, at the same time, helping to reduce the supply of drugs flowing out of the Andean region. Moreover, allowing this access will involve no cost to the American taxpayer.

Last year, Congress unanimously passed the Andean Trade Preference Act, which I introduced. That act grants duty-free treatment to imports from the Andean region in an effort to provide legitimate alternatives to coca production. However, without the necessary capital investment to create new jobs, unilateral tariff reductions, by themselves, cannot eliminate the drug problem. New productive investment is central to the strategy of developing alternative income-generating activities that will result in the creation of desperately needed jobs. Without new investment, tariff reductions become much less effective. The extension of section 936 benefits to the coca-producing South American countries would create a catalyst for new investment, leading to more jobs and critical labor alternatives for farmers who are currently employed in the drug trade. In fact, the extension of low-interest loans to the qualified Caribbean Basin Initiative countries in 1986 created approximately 20,000 new private-sector jobs as a result of nearly $650 million in section 936 investments allowed by Puerto Rico.

Allowing the Andean countries of Bolivia, Peru, Columbia, and Ecuador to have access to these same benefits would be an excellent way to stimulate their economies while, at the same time, helping to reduce the supply of drugs flowing out of the Andean region. Moreover, allowing this access will involve no cost to the American taxpayer.

The extension of section 936 benefits to the Andean countries would complement the Enterprise for the Americas Initiative (EAI) to promote economic growth and political stability in Latin America and the Caribbean.

Furthermore, the extension of section 936 benefits to the Andean countries would complement the Enterprise for the Americas Initiative (EAI) to promote economic growth and political stability in Latin America and the Caribbean. Over the past decade, countries in Latin America and the Caribbean have confronted an economic crisis that has resulted in lost trade, fewer markets, and reduced investment opportunities for the U.S. One of the pillars of the EAI is the promotion of investment in Latin America and the Caribbean, which could be accomplished through my proposal to extend low interest loans to the Andean countries. The extension of section 936 benefits to Bolivia, Columbia, Peru, and Ecuador would serve the goal of further strengthening the economic and political forces of the Western Hemisphere.

The Andean Trade Preference Act ... grants duty-free treatment to imports from the Andean region in an effort to provide legitimate alternatives to coca production. However, without ... new investment, tariff reductions become much less effective. The extension of section 936 benefits to the coca-producing South American countries would create a catalyst for new investment, leading to more jobs and critical labor alternatives for farmers who are currently employed in the drug trade.

The enactment of the Andean Trade Preference Act signalled Congress's commitment to the eradication of America's drug problem. By coupling this commitment with an extension of section 936 benefits to the Andean nations, we can more aggressively pursue this goal and, at the same time, help to forge a new relationship with our Latin American neighbors. ■

Ways & Means from page 1

foreign investment or business activity in the U.S.," and that "recent U.S. tax policy regarding foreign investment in the U.S. has come under criticism both from foreign and U.S. sources."

"Like most comprehensive tax legislation," said Williams, "H.R. 5270 has positive provisions and negative provisions. In the positive category are the proposed interest allocation rules and the removal of limitations on the alternative minimum tax foreign tax credit. The negative provisions include the repeal of deferral of income for controlled foreign corporations and the proposed minimum tax on foreign-owned U.S. corporations. "If deferral were repealed," he continued, "then some U.S. multinationals might find it more difficult to compete in the world market because foreign-owned subsidiaries in other countries could still benefit from tax incentives in various countries and from manufacturing goods in low-tax countries." Noting that our trading partners have considered some recent U.S. tax policy moves to be treaty overrides, Williams stated that "the proposal to increase tax on foreign-owned U.S. corporations could have the effect both of reducing foreign investment in the U.S. and inviting retaliation from foreign governments."

Testifying with Foundation Chief Tax Counsel Floyd Williams were, from left: Paul R. Huard of the National Association of Manufacturers, Peter L. Faber of the American Bar Association's Section of Taxation, and Jo-Renée Hunter of the ABA's Committee on Foreign Activities of U.S. Taxpayers.

Just as U.S. multinationals should not be placed at a disadvantage, U.S. tax policy should not impede foreign investment ... in the U.S.

In the Ways and Means Committee chamber, Williams chats with officers of the Tax Executives Institute: from left, Reginald W. Kawalcbuk, International President; Michael J. Murphy, Executive Director; and Timothy McCormally, General Counsel & Director of Tax Affairs.

Williams cautioned the committee that "when considering comprehensive legislation such as this, each provision should be analyzed in terms of whether it is helpful or harmful to U.S. industry. One must also ask whether it makes sense to enact benefits for some of our multinationals at the expense of other U.S. multinationals and foreign multinationals. If, in fact, our foreign trading partners were to retaliate against U.S. multinationals as a result of enactment of H.R. 5270, then any of its intended benefits would be largely negated."

Some of the members of the Ways and Means Committee present for Tax Foundation testimony: from right, Chairman Dan Rostenkowski (D-IL), J.J. Pickle (D-TX), and Charles B. Rangel (D-NY). Back row: Committee staff attorney Harrison Cohen.

Williams' testimony concluded with the offer to "assist the committee in studying ways to eliminate burdens on U.S. multinationals in a way that does not pit some U.S. multinationals against others or pit U.S. multinationals against foreign multinationals. ■

Presidential Candidates Unveil Policy Agendas

by Christopher Nelson

Presidential candidates George Bush and Bill Clinton and almost-candidate Ross Perot have recently added specifics to their economic agendas. Their ideas on deficit reduction, tax changes, regulatory reform, trade policy, spending reductions, and other major economic initiatives (see pp. 4-5) are gleaned from public statements, campaign literature, and staff interviews. Revenue estimates are presented where possible.

George Bush opposes tax increases to reduce the deficit, professing a belief that lower federal outlays and strong economic growth will suffice. He supports a balanced budget amendment and advocates some new programs for the private sector (e.g., tax incentives for real estate, health insurance, enterprise zones, and research and development).

Deficit Projections for Presidential Candidates' Economic Plans
Fiscal Years 1993 – 1996
$Billions

	'93	'94	'95	'96
Bush	341.0	274.2	218.4	217.7
Clinton	295.7	243.0	174.0	141.0
Perot	–	212.3	97.1	35.8

Bill Clinton would increase spending $200 billion over four years while trying to halve the federal deficit, spending these new funds on infrastructure, urban programs, education, and health care. He would finance these initiatives by cutting $300 billion in defense, closing corporate "tax loopholes," raising taxes on the "rich," controlling health care costs, and cutting 100,000 federal jobs.

Ex-candidate Ross Perot's economic plan combine new taxes and spending cuts to promise a budget surplus by 1998. DRI/McGraw Hill says it would boost exports, reduce long-term interest rates, and add $1 trillion in private investment over ten years. It would offer investment incentives such as capital gains tax cuts and business tax credits, cut federal programs such as Medicare and Medicaid, and raise other taxes.

See chart on pp. 4-5

Christopher Nelson is a Charles G. Koch Charitable Foundation Summer Fellow at the Tax Foundation.

	Federal Deficit	Personal Taxes	Business Taxes	Education Reform	Regulation
George Bush	• Enact a balanced budget amendment. • Control the deficit through a total freeze on domestic discretionary spending and domestic federal employment, a line-item veto, and the elimination of 246 Federal programs. • Proceed with orderly cuts in defense. • Establish spending caps on subsidy programs.	• Reduce the capital gains rate to 15.4% (increase revenue by $6.5 billion), increase the exemption for children by $500, allow a first time home buyer to take a tax credit of up to $5,000 (costs $5.4 billion), allow penalty-free IRA withdrawals for first time home buyers (costs $418 million), and make capital losses for home sellers deductible. • Eliminate tax deferral on the internal growth in value for most individual annuities. • Allow write-offs for health insurance premiums.	• Disallow the tax deductions for interest on policy loans for corporate-owned life insurance (save $1.7 billion). • Require depreciation recapture. • Restore the real-estate passive loss deductions for owners/developers. • Make permanent the R&D tax credit (costs $1 billion a year). • Low-income housing credit (costs $1.2 billion). • Investment tax allowance for newly acquired equipment (save $3.7 billion) and a targeted jobs tax credit (costs $455 million). • Simplify and enhance AMT depreciation (costs $1.1 billion).	• Expand the Department of Education's budget by $1.6 billion. • Favors national teacher testing, training for science and math teachers, a voucher system, and an increase in the Head Start Program. • Provide universal access to college loans. • Allow a deduction for interest paid on student loans (costs $2.6 billion). • Make government Pell grants available to part-time students (estimated 100,000 more Pell grants per year).	• Imposed a 90-day moratorium on new regulations. • Federal agencies should use cost/benefit analysis to examine all regulations. • Allow more rapid approval of safe new biotech products. • Allow banks to diversify their operations across state borders. • Establish an Interagency Affordable Housing Regulatory Review Board to expedite waivers to Federal regulations. • Supports the concept of a "regulatory" budget to limit the imposition of new regulations.
Bill Clinton	• Divide the budget into three parts: current services, service debt and bank failures, and investments in the future. Clinton would then limit current services, which includes most entitlement programs, to the rate of increase in personal incomes while doubling the investment budget to 18% of all federal spending. • Cut the current deficit in half within four years. • Use line-item veto to cut pork barrel projects by $9.8 billion. • Wants our allies to help pay for U.S. defense services (i.e., Germany, Japan).	• Raise the highest tax rate to about 38% on those earning over $200,000, impose a surtax on millionaires, and increase the individual alternative minimum tax (raise $82.9 billion). • Taxpayers could replace the $2,150 tax exemption per dependent with tax credit of $800 per child (saving them up to $480 per child) or a tax cut of 10% for the middle-class, but not both (costs $13 billion a year). • Expand the refundable earned income tax credit. • Cut capital gains tax rate by 50% for profits from long-term investments in new businesses (costs $200 million a year). • Fully tax Social Security benefits for the wealthy. • Opposes write-offs for health insurance premiums.	• $2 billion more in investment tax credits for new businesses. • Raise taxes $70 billion on corporations. • End deductions for investment overseas (save $1.5 billion). • Heavier taxation of U.S. subsidiaries of foreign corporations (raise $45 billion). • Make the R&D tax credit permanent (costs $1 billion a year). • Eliminate corporate tax breaks for "excessive" executive salaries (save $1.3 billion). • A tax credit for investments in plant and equipment for small and medium size businesses (costs $400 million a year). • Increase fines and taxes for corporate polluters (raise $10.1 billion) and give tax breaks for corporate recycling. • Eliminate tax breaks for certain drug companies and end the deduction for special interest lobbying expenses (save $400 million).	• Backs a national exam system, annual evaluation of all schools, $1 billion national apprenticeship system for high school graduates, reduced class size, and college loans for everyone that are to be paid back as a percentage of future income or through civil service (estimated to cost $14 billion a year, with 43% being recovered by eliminating the current $6 billion a year Federal student loan program). To pay for this program, Clinton wants to create an $8 billion national trust fund. • Fully fund the $5 billion Head Start program and make it available to all eligible 3 and 4 year-olds. • Require companies to spend 1.5% of their payroll to train workers or to contribute to a government training fund.	• Increase government regulation of employee-employer relations (requiring more "mandated benefits" and worker re-training). • Impose new regulations on the ability to transfer environmentally-safe portions of military bases to private sector uses. • States that he would "make sure federal regulators send a clear signal to the financial community not to call in loans that are performing, and not to fear making good loans to local businesses." • Require financial institutions to invest in their communities. • Minimize federal regulations in urban enterprise zones to give businesses an incentive to locate in inner cities.
Ross Perot (withdrew 7/16)	• Eliminate the deficit and create a budget surplus by 1998. • Prohibit deficit spending by the government. • Require that taxes cannot be raised without a national referendum.	• Include 85% (instead of 50%) of Social Security benefits in income (raise $7.9 billion). • Increase gasoline tax 10 cents a year for five years (raise $50 billion). • Cut capital gains tax rate. • Double federal taxes on tobacco (raise $3.8 billion). • Increase highest income tax bracket from 31% to 33% (raise $7.6 billion). • Limit mortgage interest deductions to $250,000 of mortgage debt (raise $4.6 billion). • Eliminate "bubble" effect of levying higher marginal tax rates on the upper-middle-income than on the wealthy.	• Calls for a 10% tax credit on increases in investments by businesses, that are unexpected. • Tax credit for business expenditures on worker training. • Reduce the deduction for entertainment expense from 80% to 50%.	• Increase federal spending on education, cities, and research and development by $60 billion over 5 years. • In Texas, Perot supported equality of funding for school districts, reduced class size, improved early-childhood education, a longer school year, achievement testing, teacher-competency examinations, and merit pay.	• Blamed savings and loan situation on Bush's oversight of the deregulation of financial services during Reagan administration. • Led Texas's "War on Drugs," that yielded mandated harsher sentences and more wiretapping. • Stated that his company stopped dealing with federal government due to flawed bidding process, extensive bureaucracy. • Eliminate PAC money, soft money, from campaigns.

Where provided, revenue estimates cover fiscal years 1992–1996.

Health Care	Trade	Other New Programs	Program Reductions
• A tax credit of up to $3,750 to help lower-income individuals buy health insurance. • A National Medical Billing System that he estimates will save $4 billion the first year. • Facilitate the purchase of health insurance plans for small employers and centralize the administrative system that handles health care claims. Projected new tax breaks would cost the government $100 billion over the next five years. • Limitation on malpractice awards. • Penalty-free IRA withdrawals for medical expenses. • Expansion of Community and Migrant Health Centers.	• Supports Uruguay Round of GATT to lower international trade barriers (costs $20 million). • Supports North American Free Trade Agreement (NAFTA) to open Canadian, Mexican, and U.S. markets to each other's exporters and investors. • Vigorous enforcement of U.S. laws to prevent "unfair" trade practices in the United States. • Signed bilateral investment treaties (BITs) with Czechoslovakia, Argentina, and Poland. • Has concluded numerous trade agreements with Japan and wants to expand the Structural Impediments Initiative (SIC) to further open the Japanese market. • Calls for more agricultural export subsidies.	• A nominal 3 percent increase in research and development funding for fiscal 1993 (costs $76.6 billion). • Spend $5.4 billion for the Strategic Defense Initiative (SDI) and the theater missile defense system. The proposed spending would be an increase of 31% for the program. • Pension investment reform that could create an additional $100 billion in real estate investment. • Welfare reform that would require able-bodied people to work and would simplify the process for experimentation of new welfare ideas by the states. • Supports offshore drilling and simplification of nuclear plant licensing. • Extend unemployment benefits and increase credit availability by allowing banks to operate across state lines. • Supports enterprise zones that encourage investment in economically-distressed areas. • Spend $2.8 billion on Head Start, $500 million on Weed and Seed Program, and $28.5 billion on anti-crime/drug abuse. • Requests over $1 billion in homeless assistance and $12.7 billion for the war on drugs.	• Cut defense spending by $50 billion over the next five years, while fully funding SDI. • Reduce Medicare spending by $1.3 billion more than will result from the existing 5-year budget agreement. • Advocates a reduction in the voluminous amount of federal regulations that are estimated to cost the taxpayer between $300 and $400 billion a year in compliance costs.
• National health-care system. He favors a play-or-pay system of compliance. Clinton would have employers insure their workers or pay an additional tax into a public fund to cover those who are uninsured. • Increase Medicare-B costs for individuals with annual incomes that exceed $125,000 (save $4.4 billion). • Expand Medicare to include long-term care. • Believes that affordable, quality health care should be a right, not a privilege, and he would require all businesses to pay a set amount per employee to spread risks evenly among all companies. • Require insurance companies to sell health insurance to all businesses. No individual could be denied insurance due to pre-existing conditions.	• Extend free trade. States that "protectionism is just a fancy word for giving up." • Favors the "fast track" negotiations on a free-trade agreement with Mexico that protects workers rights and environmental standards. • Believes "25 percent" of U.S. economic problems are caused by unfair Japanese trading practices and the rest by the Republican administration. • Pass a stronger Super 301 trade bill, "acting swiftly" if trading partners do not abandon unfair trading practices. • Would toughen lobbying disclosure laws and require senior government officials, who work for a U.S. Trade Representative, to pledge not to lobby for foreigners. • Wants to reduce the trade deficit through an energy policy which reduces imports through the research and development of alternative energy sources. • Wants to increase the funding for the Export-Import Bank, which is designed to assist small businesses develop export markets.	• Invest more than $50 billion a year over the next four years on put America back to work plan. • $20 billion a year infrastructure program that is part of a larger inner city plan. • Supports a government contribution of as much as $7 billion a year in investments between the government and the private sector and provide subsidies in fields like communications, high speed trains, aerospace, silicon wafers, new materials, and biotechnology. • Increase the nation's police force by 100,000 over the next few years. • Create more than 200,000 jobs, including 45,000 construction jobs, by accelerating spending on last year's highway bill. • Start a multibillion-dollar-a-year civilian research and development agency. • Create an Economic Security Council to coordinate America's international economic policy. • Raise the ceiling on mortgage guarantees for first-time home buyers. • Pressure banks to lend more and plans to raise their taxes. Clinton would also aid first-time home buyers. • Backs boot camps for juvenile offenders and would force welfare recipients to work after 2 years. • Spend $3.4 billion to build two Seawolf attack submarines that Bush cancelled. • Fund the space station. • Supports mandatory family leave option for employees.	• Eliminate 100,000 federal jobs through attrition (saving $15.3 billion). • Reduce the administrative cost of government by 3% a year (saving $75 billion). • Cut defense by 40% saving $100 billion in five years. • Cap federal health spending and use means-testing for Medicare. • Opposes federal research and development of new nuclear power plants. • Cut the White House staff by 25% to save $10 million a year.
• Contain Medicare and Medicaid costs (saving $52.8 billion). • Tax employer-paid health-care premiums for family coverage that exceeded $335 a month (raise $15.9 billion). • Test a couple of approaches to health care reform on a small scale, choosing the approach that generated the best results to be implemented nationally.	• Cited the inequity of wages, health care, benefits, etc. between the U.S. and other nations (i.e., Mexico) as an argument against free trade. • Opposed the North American Free Trade Agreement. • Blamed American trade negotiators, who often end up lobbying for the nation they dealt with, for the nation's unfair trade agreements. • Advocated tough trade policies toward Japan and other foreign competitors. For example, he would have given Japan the same "deal" on auto imports that they gave the United States.	• Invest $40 billion over 5 years on infrastructure projects (e.g., roads and new telecommunication systems). • Government cooperation with business — creating long-range strategic plans for each industry, pursuing tough trade negotiations, and granting government subsidies. • Institute a national system of "electronic town halls" where he could have explained the major political issues and the legislative choices that were available. Citizens could then choose alternatives through interactive cable T.V. and telephone voting.	• Cut discretionary programs by $33 billion (using a 10% across the board budget cut for most programs). • Cut military spending by $40 billion more than President Bush proposes over the next five years. • Make large cuts in the funding of mass transit and arts programs. • Eliminate the proposed space station. • Cut farm subsidies by $17 billion over the next five years.

Kasten Keeps Plugging for Balanced Budget/Tax Limitation Amendment To Control Federal Spending

On July 16, 1992, Tax Foundation economist Paul G. Merski interviewed Senator Bob Kasten (R-WI) about his thoughts on the nation's fiscal crisis and his proposed Balanced Budget/Tax Limitation Amendment to the United States Constitution.

Q Tax Foundation research shows that the overall tax burden on Americans is at a record high, yet federal spending and deficits continue to command an even greater percentage of our nation's income. How can this trend be reversed?

A I believe the key is to get federal spending under control. Federal spending skyrocketed in the last decade. It has outstripped reasonable levels of growth and has forced a growing deficit and tax burden on working Americans. In 1992, federal spending will increase 11 percent. During the 1980s, tax revenues jumped 72 percent, but federal spending rose 85 percent, a growth rate twice the level of inflation during the decade. A balanced budget/tax limitation amendment will force Congress to rein in spending. Congress should also grant the President line-item veto authority.

Q The idea of a constitutional balanced budget amendment is not new. In fact, it was formally proposed back in 1935. What is your rationale for the need to get a balanced budget amendment now?

A The Congress has demonstrated a total inability to control spending. This year the deficit will reach $400 billion and the total debt burden will be $4 trillion. The interest payment on this debt now takes 15 cents of every federal tax dollar sent to Washington. The real problem however, is the total size of government. This year, the federal government will spend 25 percent of the total income of the country. This is the highest level since the end of World War II. This record spending has been accompanied by sharp tax increases. By requiring a balanced federal budget and limiting the growth in taxes, a balanced budget/tax limitation amendment will force government to live within its means.

Q How is your balanced budget amendment proposal different from the recent House version that fell nine votes shy of passing, and does it have the "teeth" to make it work?

A My amendment would require a 3/5ths supermajority vote of the Senate and House in order for the rate of growth in taxes to exceed the rate of growth in national income. This is the same 3/5ths vote that the amendment requires in order for the Congress to run a deficit. The alternative amendment you mentioned lacks this parity, requiring a simple majority to raise taxes. Without supermajority vote protection, Congress will find it all too easy to continue its spending binge. Then, at the end of the year when a deficit is looming, they can simply raise taxes and blame it on the Constitution. The difference between the two versions of a balanced budget amendment is very clear: by making it tough to raise taxes, the Kasten version would result in spending restraint as the means of balancing the budget, the alternative would likely result in new tax increases.

Q Earlier this year, you had also put forth an economic growth and family tax relief proposal that called for a capital gains tax cut, IRA expansion, and a child tax credit. Would this type of plan help us grow our way out of the annual deficit situation?

A It certainly would. The severity of the deficit has been greatly increased by the recession. Any plan to reduce the deficit must be accompanied by a package of pro-growth tax cuts. This should include a capital gains tax cut, expanded IRAs, improved depreciation, passive loss relief, family tax relief, and enterprise zones. This will ensure the job creation and business expansion that will boost economic growth. The Congressional Budget Office has determined that if economic growth is increased one percentage point above current forecasts over five years, the deficit will be reduced by $258 billion. Recent history shows how important economic growth is to reducing the deficit. After declining from 6.5 percent of GDP to three percent during the low-tax, high growth period of 1983-1989, the deficit is now projected to reach almost seven percent of GDP in 1992 following a massive tax hike and several years of anti-growth policies.

Q Americans are still paying the increased taxes from the 1990 budget agreement that called for $164 billion in new revenues over five years intended to help reduce the deficit. Unfortunately, the deficit will be over $400 billion this year. Do you think additional tax increases are fueling the problem?

A Definitely, the people of Wisconsin and individuals all across the U.S. are tired of Congress's repeatedly raising their taxes only to increase spending and produce even greater deficits. In recent years tax hikes have repeatedly been justified on the grounds that they will reduce the deficit. Tax increases have not reduced the deficit, they have merely encouraged Congress to spend more money. This is confirmed in a new study by Richard Vedder, Lowell Gallaway, and Christopher Frenze titled "Taxes and Deficits: New Evidence." This study concludes, based on an analysis of 1947-1990 data, that each $1.00 of tax increases leads to $1.59 of new spending.

In the 1982 budget deal, Congress promised $3 in spending cuts for each $1 in tax hikes. The actual result was a dramatic spending increase. In 1990, the so-called budget summit deal imposed a massive tax increase on the American people. All in the name of reducing the deficit. And what was the result? Tax revenues fell dramatically — and the deficit went up instead of down. When the agreement was enacted 18 months ago, the deficit for 1992 was supposed to be $229 billion; it will in fact be closer to $400 billion. Similarly, the 1993 deficit forecast has grown by $223 billion. The reason is clear: in addition to encouraging more spending, tax increases depress the economy, destroy jobs, and ensure that a balanced budget continues to elude Congress.

Q You have been calling for more "dynamic" revenue estimates to replace the "static" estimates you feel are inadequate to properly measure the true impact of federal tax policy changes. Are these dynamic estimates attainable, and can they improve fiscal policy decision making?

A I believe that one of the greatest obstacles to enacting a pro-growth tax package is "static" revenue estimates. For example, opponents of a capital gains tax cut continually use static revenue estimates to support the claim that the proposal would increase the deficit. This is completely contrary to history and to logic. A capital gains tax cut will lower the cost of capital, increase job creation and business expansion, and boost the level of economic growth. In the process, revenues to the federal government would increase. This fact is recognized by numerous private sector economists who understand the "dynamic" effect of the proposal.

Another example of the tragedy of static revenue estimates is the recent luxury tax placed on boats. The Joint Tax Committee claimed that this tax was a revenue raiser but completely ignored the economic damage that would result from the tax. It is estimated that 19,000 boat builders lost their jobs in 1991 alone due to this tax. Therefore, the tax is actually costing the government more in lost income tax, payroll tax revenues and unemployment payments than it is raising.

Q In the past 30 years, the federal budget was balanced once and taxes were increased 56 times. With those 56 to 1 odds, what chance is there that American taxpayers will see a balanced budget anytime this century?

A The American people are tired of business as usual. They support a constitutional amendment and they are tired of high taxes and spending. Congress is starting to get the message. However, without the discipline imposed by a balanced budget/tax limitation amendment like the one I propose, I fear that Congress will largely continue its out of control spending habits. ■

FOUNDATION MESSAGE

Will Perseverance Pay Off for the Real Estate Lobby?

Floyd L. Williams, III
Chief Tax Counsel

Before enactment of the Tax Reform Act of 1986, the tax treatment accorded to rental real estate was generally quite favorable. The 1986 tax act, however, shifted tax benefits away from real estate and toward general tax rate reduction. The most significant changes, insofar as the real estate industry was concerned, included repeal of the capital gain tax differential, lengthening of depreciable lives for real property, and imposition of the passive activity loss restrictions.

The many tax advantages that were available in connection with rental real estate prior to the 1986 tax act had the cumulative effect of reducing the risks inherent in new construction, facilitating the financing of large-scale developments, maintaining rental investment during inflationary times, and reducing the rents required to provide investors with a competitive rate of return, adjusted for risk. These tax benefits also encouraged the rapid development of partnership syndications through which individuals were able to deduct losses that significantly exceeded their out-of-pocket cost for the investments. These losses were used to offset income, such as salaries, dividends, interest, etc., that was unrelated to the real estate investments.

It would appear that the Congress went too far in 1986 when it singled out rental real estate for harsher treatment than any other type of business activity under the passive activity loss limitations, which generally require the matching of losses from a "passive activity" with income of the same type. Taxpayers who are "material participants" in any business activity other than rental real estate are not restricted under the passive activity loss limits.

President Bush's State of the Union Address last January was a cause for celebration by the real estate industry. Among the proposals intended to stimulate the real estate sector of the economy were reduction of the capital gain tax, enactment of a first-time home buyer credit, penalty-free IRA withdrawals for first-time home buyers, increased pension fund investments in real estate, deductions for losses on sales of personal residences, extension of the mortgage revenue bond program and low-income housing tax credits, and passive activity loss relief.

While it is doubtful that Congress will enact all of the real estate industry's "wish list," it looks like passive activity loss relief is a real possibility this year. H.R. 4210, as passed by the House and Senate, but vetoed by President Bush, contained some measure of passive loss relief for rental real estate. However, it did not go as far as the industry would have liked because, among other things, losses generally would have been capped at 80 percent of income and relief would have applied only to existing properties, not new construction.

Notwithstanding the demise of H.R. 4210, the real estate industry has new cause for hope with the House's passage of H.R. 11. That bill would provide relief for taxpayers more than one-half of whose personal services are performed in real property trades on businesses in which they materially participate. The provision would apply to individuals involved in real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage. Moreover, it would apply to new construction, as well as to existing properties.

The real estate industry, which began its effort to achieve passive loss relief almost before the ink was dry on the 1986 Tax Act, can finally see light at the end of the tunnel. This may be a case where perseverance finally pays off.

Two-Day Workshop on Transfer Pricing at NYU Brings Corporate and Academic Expertise to Congressional Staff

The Tax Foundation and New York University sponsored a transfer pricing workshop May 28-29 in New York City. The audience was a mixture of executives and professors with transfer pricing expertise and congressional staff seeking to enhance their expertise.

Speakers not pictured were David Rosenbloom and Pat Lewis of Caplin & Drysdale, Harrison Cohen and Daniel Berman of the Joint Tax Committee, Bin Srinidhi of Rutgers, Robert Halperin of Fordham, Barbara Rollinson and Warren Crowdus of the Treasury Department, Scott Farmer of Miller & Chevalier, Joel Williamson of Mayer, Brown & Platt, and James Carter of the Organization for International Investment. ■

Professor Joshua Ronen of New York University explained the theory of transfer pricing from an economist's perspective.

At center, Tax Foundation Chief Tax Counsel Floyd Williams chats with members of the first panel on transfer pricing: from left, Thomas Joyce, Partner, Price Waterhouse; Buck Menssen, Staff Vice President, 3M; and Catherine Porter, Partner, Miller & Chevalier.

Congressional staffers of tax-writing committees: Bob Oswald from the office of Representative Willis Gradison, Judy Hill from the office of Senator Orrin Hatch, and Joe Gale from the office of Senator Daniel Patrick Moynihan.

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Dinner and Conference
November 18, 1992

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TAX FOUNDATION

IN THIS ISSUE

Clinton Tax Plan in Perspective 1
"Front Burner" 1
Tax Index 4
Tax Collections by Income Class 6
Russian Taxation of Foreign Investment 7
Foundation Message 7
Talent Development 8

Clinton Tax Plan Would Edge 1982 Act As Biggest Tax Hike Ever

The economic plan presented by presidential candidate Bill Clinton includes a tax hike that would be the largest tax increase in modern times. It would raise a record $219 billion in 1992 dollars over four years, $84 billion of which constitutes the net employer cost of spending 1.5 percent of payroll on education and training. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) stands as the largest tax increase passed to date.

The confusion over which tax increases are the largest stems from a failure to measure federal revenue gains in comparable terms. The Tax Foundation has compared the revenue impact of the 14 major tax bills passed by the federal government since 1981 with the projected impact of the plans offered by President Bush and Governor Clinton, measured in current dollars, as a percentage of GDP and in constant 1992 dollars (see table on page 3).

The pledge-breaking tax increase President Bush signed into law in 1990, the Omnibus Budget Reconciliation Act of 1990 (OBRA'90), will raise over $125 billion in new tax revenues by 1994 and currently ranks as the second largest tax increase after TEFRA.

While TEFRA's tax hikes followed the largest tax cut ever, the proposed Clinton tax hikes would overlap with the major tax increases enacted under OBRA'90. Most of Clinton's tax increases would come from higher income taxes on individuals earning over $200,000 per year, increased Medicare-B payments, and additional taxes on domestic and foreign corporations.

While President Bush has failed to quantify his recent pitch for across-the-board tax relief, the measurable components of his Budget's tax proposals would result in a $13.6 billion revenue reduction in four years, or 0.3 percent of GDP. While his capital gains tax reduction and his flexible IRA items are scored as a small revenue gain in the short term, most of the reduced revenues would be the result of his investment tax allowance, family tax allowance, and first-time homebuyer tax credit. ■

FRONT BURNER

Encourage Savings by Expanding IRA Incentives

William V. Roth, Jr.

As a strong supporter of individual retirement accounts (IRAs) for years, I was very disappointed in 1986 when the U.S. Congress, over my objections, subjected them to severe limits. Those limits have made IRAs much less attractive than when they were originally enacted. For example, under current law, a taxpayer without a pension plan can be denied an IRA because his or her spouse has a pension plan at work and their joint income exceeds specified levels. Since 1986, I have been working hard to restore IRAs to their former position as an incentive for individual savings. Early in 1991, Senator Lloyd Bentsen, Chairman of the Committee on Finance, joined me in an effort to do just that — and more. Our proposal was to offer taxpayers the choice of a new kind of IRA. If chosen by the taxpayer, contributions to this new IRA would not be tax deductible; however, savings could be withdrawn free of tax if the contributions remain in the account for at least five years. Similar to present law, annual contributions to either IRA combined could not exceed $2,000, indexed for inflation.

American families, today, are facing an uphill battle when it comes to saving money for life's big essentials, such as a college education, buying a first home, excessive medical bills, or even that lapse between jobs when they often find themselves short. That is why, for several years now, I have been pushing my plan to improve American families' ability to save through IRAs.

Why do I think that IRAs are so important, not only to American families but also to the

See Roth on page 2

William V. Roth, Jr., Republican senator from Delaware since 1971, serves on the Senate Finance Committee and is Ranking Minority Member of its Subcommittee on Taxation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Roth from page 1

American economy as a whole? It is because IRAs encourage savings, self reliance, and an opportunity for Americans to invest in, and prepare for, the future. It is sound economic policy that promotes savings in a way that allows Americans to meet their unique and individual requirements.

The Bentsen-Roth IRA proposal is particularly significant because of the choices that it offers families who save through IRAs. Americans could realize tax savings either up front when they open an IRA, or when they withdraw from it. They could use their savings before retirement, without penalty, to pay for college educations, first-time home purchases, catastrophic health care costs, and periods of long unemployment. Through the Bentsen-Roth IRA, families could work together, and the benefits would be multi-generational. For example, grandparents could withdraw from their IRAs to help their grandchildren through college. Moreover, parents could help their children buy a first home. It would even be possible for grandchildren to make penalty-free withdrawals to help their grandparents pay for catastrophic medical bills.

Contributions to this new IRA would not be tax deductible; however, savings could be withdrawn free of tax if the contributions remain in the account for at least five years.

Public support for my proposal has been very strong. I have received thousands of letters supporting the restoration of IRAs. Americans need the IRA to be restored today. IRAs are a tried and true method of creating more savings in this country. An increased savings rate will create economic growth, and a growing economy will create jobs.

When the Senate Finance Committee recently approved H.R. 11, the "Revenue Act of 1992," it broadened the IRA provision, at my urging, to allow families receiving subsidies under the Aid to Families with Dependent Children (AFDC) program to save a limited amount in an IRA account. Currently, AFDC recipients are not allowed assets of more than $1,000. I believe that savings and education are the means by which lower-income families can break out of the welfare dependency cycle, and that my IRA proposal will help give these families a way out of the welfare trap.

Grandparents could withdraw from their IRAs to help their grandchildren through college, and it would even be possible for grandchildren to make penalty-free withdrawals to help their grandparents pay for catastrophic medical bills.

The Bentsen-Roth IRA jumped another hurdle this August when the Senate, by a vote of 72-25, beat back a proposal that would have struck the provision from the 1992 Revenue Act. The bill was later modified by agreement on a Metzenbaum amendment, placing caps of $80,000 for a single taxpayer and $120,000 for a joint return, indexed for inflation. While I would have preferred to see the Bentsen-Roth Super IRA pass in its original form, I am pleased by the major improvements to the current IRA that would be made by the Senate's agreement.

The recent Senate action represents a three-fold increase over previous limitations placed on IRAs. In other words, where once only families earning under $40,000 could benefit from IRAs, the Senate bill would allow families earning up to $120,000 to participate. Furthermore, the $120,000 income limit would be indexed for inflation.

Where once only families earning under $40,000 could benefit from IRAs, the Senate bill would allow families earning up to $120,000 to participate. Furthermore, the $120,000 income limit would be indexed for inflation.

While I would like to see IRAs made available to all Americans, I am encouraged that the Senate's compromise will increase the number of eligible families from approximately 50 percent to almost 90 percent. The fact that the Senate's bill would expand the eligibility of IRAs to cover about 90 percent of Americans represents a major step toward our objective of increasing the amount of savings for capital investment — investment that our nation seriously needs to realize its own bright economic future, and to remain first among equals in the emerging global community.

I must admit, of course, that the Senate's compromise provision is not without its flaws. I am concerned, for example, that placing a cap on who can and who cannot save will create inconsistencies for families in their financial planning. I am also concerned about the lack of fairness that results from excluding those families that will not be able to participate. Take the farmer who has a good year and might earn $120,000, and then has one or two bad years. In his good year, he will not be allowed to save; in his bad years, he may not have enough to save. This same example could apply for other men and women engaged in professions such as acting, real estate, athletics, etc., where annual income is unstable and often unpredictable.

The Senate's bill would expand the eligibility of IRAs to cover about 90 percent of Americans — a major step toward our objective of increasing savings for capital investment.

It is my opinion that America needs a stable, long-lasting program with strong congressional support — a program Americans can count on. While the Senate's version of Bentsen-Roth is a step in the right direction, it leaves more to be done. I hope that when the moment is appropriate, we will complete our full objective. ■

Major Federal Tax Legislation, 1981 – 1991, Compared to the Tax Plans of President George Bush and Presidential Candidate Bill Clinton

Revenue Impact Expressed in Current Dollars, Percent of GDP, and 1992 Dollars (a)

Dollar Amounts in $Billions

Fiscal Year	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Economic Recovery Tax Act of 1981															
In current dollars	-35.6	-91.1	-136.8	-170.3	-209.8	-238.5	-258.7	-282.0	-309.4						
As % of GDP	-1.1	-2.7	-3.6	-4.2	-4.9	-5.3	-5.3	-5.4	-5.6						
In 1992 dollars	-52.0	-128.9	-185.4	-222.9	-269.7	-295.5	-308.0	-320.1	-333.4						
Tax Equity and Fiscal Responsibility Act of 1982															
In current dollars		16.6	36.0	39.2	46.7	56.5	57.3	55.7	57.2	61.2					
As % of GDP		0.5	1.0	1.0	1.1	1.2	1.2	1.1	1.0	1.1					
In 1992 dollars		23.5	48.8	51.3	60.0	70.0	68.2	63.2	61.6	63.3					
Highway Revenue Act of 1982															
In current dollars		1.5	4.1	4.2	4.5	4.7	4.9	5.1	5.1						
As % of GDP		b	0.1	0.1	0.1	0.1	0.1	0.1	0.1						
In 1992 dollars		2.1	5.6	5.5	5.8	5.8	5.8	5.8	5.5						
Social Security Amendments of 1983															
In current dollars			5.7	8.7	10.2	12.1	24.6	30.9	23.4	23.8	25.2				
As % of GDP			0.2	0.2	0.2	0.3	0.5	0.6	0.4	0.4	0.4				
In 1992 dollars			7.7	11.4	13.1	15.0	29.3	35.1	25.2	24.6	25.2				
Railroad Retirement Revenue Act of 1983															
In current dollars			0.2	0.7	1.1	1.1	1.2								
As % of GDP			b	b	b	b	b								
In 1992 dollars			0.3	0.9	1.4	1.4	1.4								
Deficit Reduction Act of 1984															
In current dollars			0.9	9.3	16.1	22.0	25.4	27.7	31.0	33.8					
As % of GDP			b	0.2	0.4	0.5	0.5	0.5	0.6	0.6					
In 1992 dollars			1.2	12.2	20.7	27.3	30.2	31.4	33.4	35.0					
Consolidated Omnibus Budget Reconciliation Act of 1985															
In current dollars					0.9	2.7	3.0	3.0	3.0	3.2	3.5				
As % of GDP					b	0.1	0.1	0.1	0.1	0.1	0.1				
In 1992 dollars					1.2	3.3	3.6	3.4	3.2	3.3	3.5				
Omnibus Budget Reconciliation Act of 1986															
In current dollars						2.6	2.4	2.0	1.0	0.1	1.0				
As % of GDP						0.1	b	b	b	b	b				
In 1992 dollars						3.2	2.9	2.3	1.1	0.1	1.0				
Continuing Resolution for 1987															
In current dollars							2.8	3.0	2.6	2.6	2.6				
As % of GDP							0.1	0.1	b	b	b				
In 1992 dollars							3.3	3.4	2.8	2.7	2.6				
Tax Reform Act of 1986															
In current dollars						18.6	-8.9	-24.4	-20.3	-16.4	-20.9				
As % of GDP						0.4	-0.2	-0.5	-0.4	-0.3	-0.4				
In 1992 dollars						23.0	-10.6	-27.7	-21.9	-17.0	-20.9				
Omnibus Budget Reconciliation Act of 1987															
In current dollars							8.6	13.9	16.1	15.4	12.2				
As % of GDP							0.2	0.3	0.3	0.3	0.2				
In 1992 dollars							10.2	15.8	17.3	15.9	12.2				
Continuing Resolution for 1988 and Family Support Act of 1988															
In current dollars							2.0	2.8	2.8	3.0	3.0	2.9			
As % of GDP							b	0.1	0.1	0.1	0.1	b			
In 1992 dollars							2.4	3.2	3.0	3.1	3.0	2.8			
Omnibus Budget Reconciliation Act of 1990															
In current dollars										22.5	35.2	32.7	37.5	38.6	31.0
As % of GDP										0.4	0.6	0.5	0.6	0.5	0.4
In 1992 dollars										23.3	35.2	31.7	35.2	35.1	27.3
Tax Extension Act of 1991 and Emergency Unemployment Compensation Act of 1991															
In current dollars											3.5	0.7	0.2	0.8	1.3
As % of GDP											0.1	b	b	b	b
In 1992 dollars											3.5	0.7	0.2	0.7	1.1
President George Bush's *Fiscal 1993 Budget of the U.S.*															
In current dollars											-5.2	-3.7	-1.5	-3.8	-4.1
As % of GDP											-0.1	-0.1	b	-0.1	-0.1
In 1992 dollars											-5.2	-3.6	-1.4	-3.5	-3.6
Bill Clinton's *National Economic Strategy for America* (c)															
In current dollars												52.7	59.1	61.2	65.4
As % of GDP												0.8	0.9	0.9	0.9
In 1992 dollars												51.1	55.5	55.6	57.6
Fiscal Year	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**

a) Revenue effect estimates prepared by the Office of Management and Budget for the purpose of budget presentation. They measure the direct effect of tax legislation on receipts with feedback effect limited to the overall income forecast and its impact on receipts by major source. 1992 dollar figures adjusted by CPI-X1.

b) Less then 0.1 percent of GDP.

c) Includes $21 billion per year for net new cost to employers from Clinton's mandate that 1.5% of payroll be spent on education and training.

Sources: Tax Foundation; Office of Management and Budget, Budget of the U.S. Government (FY1964 – 1993); and *A National Economic Strategy for America* issued by Arkansas Gov. Bill Clinton, 6/21/92.

U.S. Tax Index At Record High; Corporate Taxes Grow Fastest Over Decade

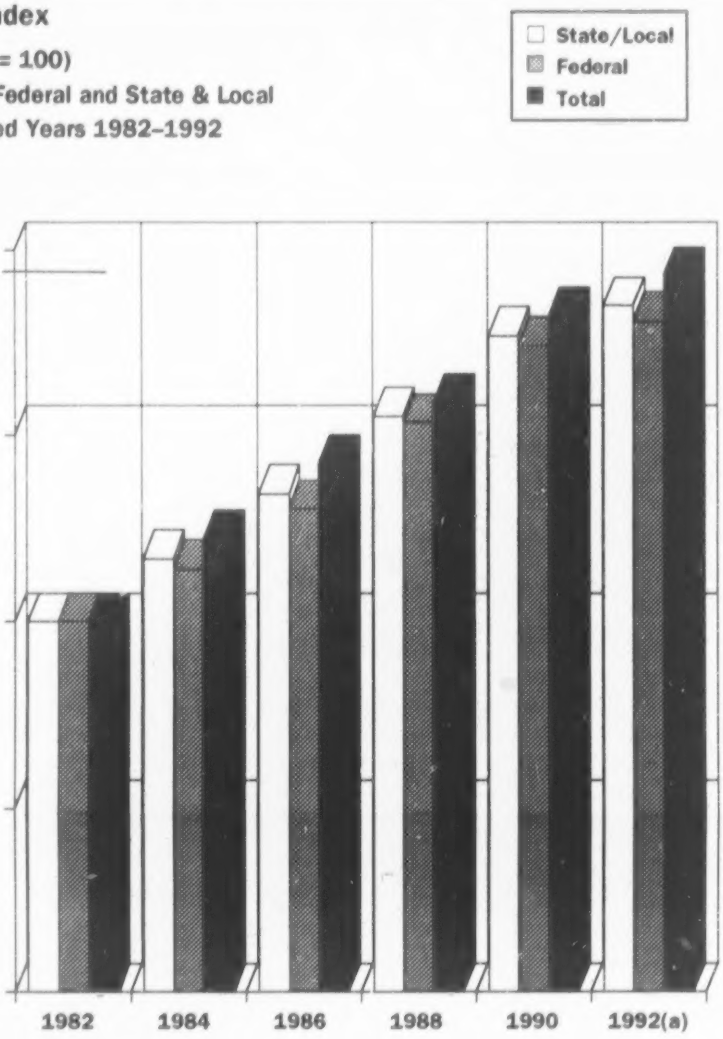
The U.S. Tax Index climbed to a new high of 185.0 in the second quarter of 1992 (1982 = 100), representing a total tax bill 85 percent greater than the amount collected in 1982. During the first half of this year, federal, state, and local taxes were collected at a rate that would total a record $1.781 trillion if continued for the remainder of the year.

Tax Index

(1982 = 100)

Total, Federal and State & Local

Selected Years 1982–1992



(a) Based on annualized data, Q1 and Q2 1992.
Source: Tax Foundation.

The Tax Index is a fiscal yardstick designed by Tax Foundation economists to provide a continuing current measure of the trends in taxes at the federal, state, and local levels. It is similar to other economic indicators such as the familiar Consumer Price Index. Over the past decade, the state/local Tax Index (now at 193.2), shows that state tax increases have continued to outpace federal tax growth. The federal Tax Index now stands at 180.8. While federal taxes showed 6.14 percent average annual increases since 1982, state/local taxes increased even faster at 6.84 percent.

Because of continued weak economic growth, the bulk of recent tax revenue growth is actually the result of legislated tax increases at both the federal and state levels. The Omnibus Budget Reconciliation Act passed by the President and Congress on November 5, 1990, increased federal taxes by $164 billion over five years. States have collectively legislated $35.3 billion worth of tax increases since 1990.

Tax Growth Outpaces Economy

Tax increases, mirrored in the average 6.4 percent annual increases in the total Tax Index over the past decade, have outpaced the 2.5 percent annual growth in personal income, the 3.9 annual average growth in the Consumer Price Index, and Gross Domestic Product (GDP) which grew an average of 2.7 percent annually during this same period. Thus, total taxes have risen faster than individuals' incomes, inflation, and the economy as a whole.

Corporate Taxes Rise Fastest

Examination of the Tax Index since the trough of the previous recession (fourth quarter 1982), reveals that corporate profit taxes increased 126.1 percent by 1992 — far outpacing the growth in all other sources of tax revenues. Other significant increases for this period are seen in Social Security taxes, up 103.4 percent; personal property and estate taxes, up 97.5 percent; and sales and indirect business taxes (excises, customs and real property taxes), up 93.5 percent. While Uncle Sam saw the fastest growth rate in tax revenues from corporations, state/local governments witnessed the sharpest growth in their personal income tax levies. The accompanying table and chart provide further detail. ■

Tax Index

(1982 = 100)

Total, Federal, and State and Local

Selected Periods 1965 – 1992

Calendar Year	All Taxes	Personal Income Taxes	Corporate Profits Taxes	Sales & Indirect Business Taxes(a)	Social Insurance Contributions	All Other Taxes(b)
			Total Tax Index			
1965	19.1	16.0	49.0	23.5	11.5	24.1
1970	30.5	28.7	54.4	35.4	22.4	33.6
1975	48.6	41.2	80.7	54.6	43.9	55.6
1980	85.9	84.2	134.4	82.6	80.3	83.4
1981	97.7	97.4	128.5	97.2	93.2	91.3
1982	100.0	100.0	100.0	100.0	100.0	100.0
1983	105.9	99.4	122.3	109.2	107.6	98.3
1984	116.9	106.4	149.4	120.7	120.5	106.2
1985	126.7	117.6	153.1	128.7	131.2	117.4
1986	134.2	123.2	168.8	134.7	140.8	129.5
1987	146.2	138.0	201.4	142.3	148.6	136.9
1988	154.9	141.9	217.1	150.3	164.1	146.5
1989	168.4	159.6	223.9	161.7	175.6	161.4
1990	176.9	166.1	216.5	173.2	186.3	183.8
1991	181.8	164.9	196.5	185.3	196.1	191.3
1992 (c)	185.0	164.0	226.1	193.5	203.4	197.5
			Federal Tax Index			
1965	19.6	17.3	58.9	31.2	11.1	37.3
1970	30.3	30.1	62.3	36.6	21.9	49.3
1975	46.4	40.8	88.8	48.7	43.5	65.3
1980	87.0	84.5	143.2	79.7	79.9	86.7
1981	100.6	98.3	133.8	115.3	93.6	92.0
1982	100.0	100.0	100.0	100.0	100.0	100.0
1983	103.8	97.1	124.8	107.6	108.0	77.3
1984	114.2	102.2	153.6	116.3	121.8	80.0
1985	124.1	113.9	155.4	117.9	133.0	85.3
1986	130.1	118.6	170.7	107.6	142.2	93.3
1987	143.8	133.2	210.2	117.5	150.3	96.0
1988	153.1	136.4	226.1	122.5	167.0	101.3
1989	166.7	153.4	238.5	124.5	179.0	118.7
1990	174.3	159.4	232.0	132.8	190.3	154.7
1991	176.6	156.5	208.8	157.3	200.3	146.7
1992 (c)	180.8	153.8	241.3	160.0	207.7	144.7
			State and Local Tax Index			
1965	18.1	8.5	14.3	21.7	14.0	18.1
1970	30.9	21.0	26.4	35.2	25.7	26.5
1975	53.0	43.4	52.1	56.0	46.9	51.2
1980	83.7	82.1	103.6	83.3	83.0	81.9
1981	92.2	92.3	110.0	92.8	90.8	91.0
1982	100.0	100.0	100.0	100.0	100.0	100.0
1983	109.9	112.3	113.6	109.6	105.3	107.8
1984	122.1	130.1	135.0	121.7	112.3	118.1
1985	131.8	138.9	145.0	131.2	119.6	131.9
1986	142.1	149.1	162.1	141.2	132.1	145.8
1987	150.9	165.7	170.7	148.2	137.4	155.4
1988	158.5	173.2	185.7	156.9	145.0	166.9
1989	171.8	195.4	172.9	170.6	153.1	180.7
1990	182.2	204.2	162.1	182.9	160.1	197.0
1991	191.8	212.5	153.6	192.0	169.3	211.4
1992 (c)	193.2	221.9	172.9	201.5	176.0	221.4

(a) Indirect business taxes consist primarily of excises, customs levies, and real property taxes.

(b) Primarily estate and gift and personal property taxes.

(c) Based on annualized data, Q1 and Q2 1992.

Source: Tax Foundation and U.S. Department Of Commerce, Bureau of Economic Analysis.

Tax Foundation Policy Council Meets in NYC

At right, Senator Harry F. Byrd, Jr., Policy Council member and recipient of the Tax Foundation's Distinguished Service Award, greets Congressman Bill Frenzel who led the Foundation's recent delegation to Moscow (see p. 7).

At left, Foundation Co-Chairman James C. Miller III speaks with Lawrence Kudlow, chief economist for Bear Stearns and new member of the Foundation's Policy Council.

From left: Kendyl K. Monroe, Partner, Sullivan & Cromwell; Gwain Gillespie, Vice Chairman, UNUM Corporation; and Ronald Bunn, Director of Corporate Development at the Tax Foundation.

Top Tenth of U.S. Taxpayers Pay Over Half of Federal Income Taxes

The top ten percent of income earners paid 53.9 percent of all federal individual income taxes, according to Tax Foundation analysis of recently released 1990 tax return data from the IRS.

The share of the tax burden borne by those at the upper end of the income scale has steadily increased over the decade, from 48.6 percent in 1980 to 53.9 percent in 1990, despite claims that tax legislation during the 1980s was kindest to those at the top. Their average 1990 tax payment of $22,342 was 9 percent greater than in 1980 after adjusting for inflation. The top 10 percent of income earners may conjure up images of high society to some people, but actually the adjusted gross income (AGI) for this group reached down to $63,818, not far from 1990's two-earner median family income of $50,898.

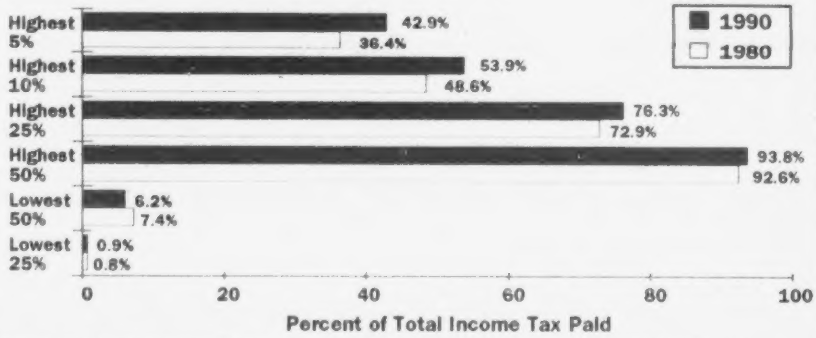
The income necessary to place in the top 5 percent of income earners in 1990 was $80,867. Even this level hardly qualifies for "Lifestyles of the Rich and Famous." Furthermore, among all taxpayers, those in this income group saw their federal individual income tax burdens rise the fastest. Their portion of individual income taxes climbed 17 percent, from 36.4 percent in 1980 to 42.9 percent in 1990.

At the other end of the spectrum, taxpayers in the bottom 50 percent of income earners saw their share of income taxes decline 16.2 percent, from 7.4 percent in 1980 to 6.2 percent of the federal take in 1990. In the face of allegations that the benefits of the Economic Recovery Tax Act of 1981 and Tax Reform Act of 1986 went mostly to the wealthy, these numbers demonstrate clearly that tax policies during the 1980s maintained the progressivity of the federal income tax system, as top income earners continue paying a larger share of federal tax collections.

Recent tax changes aimed at this group are likely to extract an even greater chunk of the tax take. Starting in 1991, the Omnibus Budget Reconciliation Act of 1990 increased the tax rate on top earners from 28 percent to 31 percent, restricted their itemized deductions, phased out the value of their personal exemptions, increased the alternative minimum tax rate from 21 percent to 24 percent, and subjected more of their income to Medicare payroll taxes.

Lowering tax rates and broadening the income tax base have actually led to greater federal revenues. In 1990, the 113.8 million tax returns reported an AGI of $3.4 trillion, up $140 billion over 1989. Taxation of unemployment compensation leaped 28.6 percent from $12.1 billion in 1989 to $15.6 billion in 1990. Taxable IRA distributions climbed 27 percent as a result of the Tax Reform Act of 1986, and taxable Social Security benefits rose 13.5 percent. Salaries and wages, by far the largest component of AGI (72.6 percent), increased $148 billion in 1990. In the end, the total income tax take for the federal government was a record $451.4 billion. ■

Percent of Federal Individual Income Taxes Paid by High and Low Income Taxpayers, 1980 and 1990



Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

Federal Income Taxes Paid by High and Low-Income Taxpayers, 1980 and 1990[a]

Adjusted Gross Income Class	Income Level		Percent of Tax Paid		Average Tax	
	1980	1990	1980	1990	1980	1990
Highest 5%	42,079 or more	80,867 or more	36.4%	42.9%	19,327	35,558
Highest 10%	35,965 or more	63,818 or more	48.6	53.9	12,893	22,342
Highest 25%	23,603 or more	39,865 or more	72.9	76.3	7,737	12,668
Highest 50%	12,980 or more	19,616 or more	92.6	93.8	4,911	7,784
Lowest 50%	12,979 or less	19,615 or less	7.4	6.2	395	514
Lowest 25%	5,930 or less	8,721 or less	0.8	0.9	86	145
Lowest 10%[b]	2,250 or less	3,205 or less	0.1	0.2	27	67

[a] Data for 1990 are preliminary.

[b] Includes returns showing no adjusted gross income.

Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

1990 Income Tax Data

Adjusted Gross Income Class	Total Individual Returns (thousands)	Total Adjusted Gross Income ($billions)	Percent of Adjusted Gross Income	Average Tax Rate
Highest 5%	5,690	958	27.93%	21.11%
Highest 10%	11,380	1,320	38.45	19.27
Highest 25%	28,450	2,154	62.77	16.73
Highest 50%	56,899	2,951	86.00	15.01
Lowest 50%	56,899	480	14.00	6.08
Lowest 25%	28,450	92	2.67	4.49
Lowest 10%[a]	11,380	-7	-	-

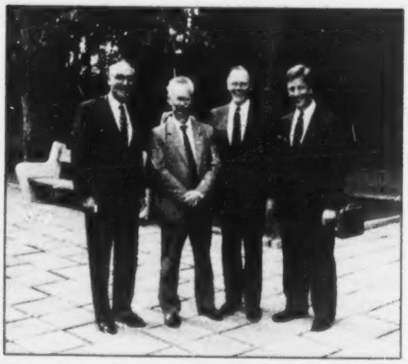
[a] Includes returns showing no adjusted gross income.

Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

Foundation Delegation Helps Russia with Taxation Of Foreign Investment

Accepting an invitation from Russia's State Committee on Taxation and Ministry of Finance to help develop guidelines for future laws governing the taxation of foreign investment in Russia, the Tax Foundation led a delegation of noted tax experts to Moscow from July 1-7, 1992.

Former Soviet President Mikhail Gorbachev speaks to Tax Foundation Executive Director Dan Witt (c.) and George Reardon, Director of Taxes, Archer Daniels Midland Company.



From left: Alan J. Lipner, Senior Vice President - Corporate Taxes, American Express Company; Mikhail Mitiukov, Chairman, Committee on Legislation, Supreme Soviet of Russia; James Q. Riordan, Esq.; and David C. Jory, Vice President, Citicorp/Citibank, N.A.

Vice President Aleksandr Rutskoi (L) greets Foundation Executive Director Dan Witt.

The delegation's statement has been published as a Foundation Special Report titled *Tax Aspects of Improving the Investment Climate in Russia.*

The delegation was led by Congressman Bill Frenzel and included Dr. Charles C. McLure, Jr., Hoover Institution, Stanford University; Edward Lieberman, Esq., Pepper, Hamilton & Scheetz; Bruce S. Brown, Philip Morris Companies Inc.; Ken Crawford, KPMG Peat Marwick; Robert S. Enright, PepsiCo, Inc.; Richard Gordon, Arthur Andersen & Co.; David C. Jory, Citicorp/Citibank, N.A.; Ian Lee-Leviten, RJR Nabisco, Inc.; Alan J. Lipner, American Express Company; Daniel H. Payne, BHP Minerals Incorporated; George W. Reardon, Archer Daniels Midland Company; James Q. Riordan, Esq.; Jack R. Skinner, Halliburton Co; and Dan Witt, Tax Foundation.

Russian officials involved included: Aleksandr V. Rutskoi, Vice President; A.G. Shapovaliantz, Deputy Minister of the Economy; Aleksandr Pochinok, Chairman, Committee on Budget and Prices, Supreme Soviet of Russia; Sergei Filatov, First Deputy Chairman, Supreme Soviet of Russia; and I.A. Lazarev, Chairman, State Committee on Taxation. ■

FOUNDATION MESSAGE

Applying the Principles of Taxation to the Russian Economy

Dan Witt
Executive Director

A successful Russian transition to a free market is important for many reasons, most notably because it will improve the living standard of the Russian people and enhance the prospects for world peace. That is why the Foundation accepted the invitation from Russia's State Committee on Taxation and Ministry of the Economy to assemble a delegation of tax experts which could guide the new Russian government in the most reasonable way to tax foreign investment. On July 7, we submitted recommendations to Vice President Aleksandr V. Rutskoi and I.A. Lazarev, chairman of the Russian State Tax Committee.

The statement urges the Russian government to make Western companies partners in Russia's transition by structuring its tax code to make investing in Russia competitive with other international investment opportunities. To achieve this, the Russian tax system must satisfy the objectives of taxpayers and the government. In short, prosperity in Russia requires that the tax system encourage the saving and investment that are necessary for economic progress.

In all the delegation's meetings with representatives of the government, the Parliament, and the State Tax Service, the views we shared are consistent with the Tax Foundation's long-established "Principles of Taxation." These principles include moderate tax rates, stability, reliability, simplicity, clarity, economic neutrality, the need for open discussions of policy, fair taxation of international transactions, and the importance of applying these principles to the taxes of subnational as well as national governments.

We realize, of course, that major changes in the Russian tax code are made for more reasons than the advice of American experts, but we are nonetheless gratified to see that three days after we submitted our statement, the Russian Supreme Soviet voted to reduce the maximum personal income tax rate from 60 percent to 40 percent. Then less than a week later, the Supreme Soviet reduced the value-added tax on a variety of consumer goods, and the Russian parliament rejected President Boris Yeltsin's bid to impose a VAT specifically on imports. The VAT will remain 28 percent for most goods and services until 1993, when the rate will be lowered to 20 percent for most goods.

The delegation appreciated the difficulty of reducing public expenditures, including subsidies to state enterprises, but made clear that this is exactly the course needed to stimulate the private sector's ability to grow and create employment. Naturally, this lesson is not just for Russians. Public expenditures in the U.S. have exceeded the federal government's revenue-raising ability every year since 1969, and our sermons on keeping tax codes simple would have been more persuasive if our own were not a monument to complexity.

Students and Young Researchers Learn Public Finance Ropes at Tax Foundation

Alide Roede

Alide Roede, a citizen of the Netherlands who spent time with the Tax Foundation this past winter and spring, recently completed work on a final thesis for her master of law in taxation. Her research compared the taxation of gains from dealings in property under U.S. and Netherlands law.

Fortunately, her internship coincided with congressional consideration of H.R. 4210, the "Tax Fairness and Economic Growth Act of 1992." She was able to view first hand the federal legislative process and prepare a detailed report of various capital gains taxation proposals.

Elizabeth Gutierrez, a Princeton undergraduate, studied entitlement financing during her summer stint.

Christopher Nelson, a senior at Duquesne University School of Law and a Charles G. Koch Charitable Foundation Summer Fellow, authored a comparison of the presidential candidates' economic platforms (see Aug. *Tax Features*) as well as a paper on alternative tax systems.

Peter J. Neff devoted much of his time to the Foundation's annual *Facts and Figures on Government Finance*, and worked on a variety of regular Tax Foundation research stories, such as tax collections by income class (see p. 6) and the tax index (see pp. 4-5). ■

From left: Christopher Nelson, Charles G. Koch Charitable Foundation Summer Fellow; Paul Merski, Tax Foundation's director of fiscal affairs; and Peter J. Neff, recent accounting graduate of Catholic University.

Elizabeth Gutierrez, undergraduate economics student at Princeton University.

Mark Your Calendar
for the
Tax Foundation's 55th Annual Dinner and Conference
November 18, 1992
at the Waldorf-Astoria in New York City

Recent Foundation Publications

Tax Aspects of Improving the Investment Climate in Russia	**4 pp.; $8 + $2 p/h**
Seminar Proceedings: EC'92 and its Implications for Global Competitiveness	**24 pp.; $10 + $2 p/h**
Facts and Figures on Government Finance, 1992	**Cloth; 359 pp.; $55 + $2 p/h**

Tax Features

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Tax Features

Congressman Bill Frenzel Joins Tax Foundation as Distinguished Fellow

The Honorable Bill Frenzel, Republican congressman from Minnesota's third district from 1971 to 1991, has joined the Tax Foundation as a distinguished fellow. Congressman Frenzel was the Ranking Minority Member of the House Budget Committee and the House Administration Committee. He also served on the House Ways and Means Committee and its subcommittee on trade, and was a congressional representative to the General Agreement on Tariffs and Trade (GATT).

Invited by the Russian government to give advice on the taxation of foreign investment, the Tax Foundation assembled a delegation of tax experts with Bill Frenzel as its leader. Now a Distinguished Fellow at the Foundation, Congressman Frenzel (L) is seen here being greeted in Moscow by S.V. Gorbachev, Deputy Minister of Finance.

Highly regarded on both sides of the aisle during his tenure in the House of Representatives, Frenzel was described by Congressional Quarterly's *Politics in America* as "a workhorse and a true professional." On the trade subcommittee of the Ways and Means Committee, he was a vigorous exponent of free trade, fighting the adoption of protectionist measures by Congress here in the U.S. and their adoption by other nations as part of GATT. He particularly opposed the notion that we should automatically impose trade restrictions on nations that run a trade surplus with the U.S.

Frenzel attended Dartmouth College where he received his B.A. and M.B.A. He worked in the private sector as a warehouse company executive before beginning his public sector career in the Minnesota House in 1963. ■

TAX FOUNDATION

IN THIS ISSUE

Frenzel Joins Foundation 1
"Front Burner" 1
Family Tax Burden 3
Interview with Senator Bob Smith 4
Foundation Message 7
Murray and Greenspan to Receive Awards 8

FRONT BURNER

Don't Penalize Higher Education with The Tax Code

David Boren

Unlike the Cold War era when military might reigned supreme, nations in the transformed world in which we find ourselves today must learn to compete primarily in the economic and intellectual realms. So too must people be able to adapt to our new environment and anticipate the direction of future change. A robust educational system with world-class institutions of higher education, both public and private, is vital to our future development.

The Tax Reform Act of 1986 contained two provisions that were particularly detrimental to institutions of higher education. One dealt a blow to donations of appreciated property to nonprofit organizations, and the other hurt tax-exempt bonds issued by private colleges and universities. Although our need for education continues to increase, these provisions are indicative of the fact that the federal government's financial commitment to colleges and universities is decreasing. Furthermore, tax policy now discriminates against private institutions of higher education. While some decrease in support of higher education may be inevitable given current federal, state, and local budgetary constraints, the federal government should not at the same time hamper the efforts of colleges and universities to find private support or to borrow funds for their capital needs.

Senators John C. Danforth (R-MO) and Daniel Patrick Moynihan (D-NY) have joined me in introducing legislation, the Charitable Contribution Tax Act, which would reverse this disturbing trend by repealing these two adverse provisions of the 1986 Tax Act. The broader tax

See Boren on page 2

David Boren, Democratic senator from Oklahoma since 1979, serves on the Senate Finance Committee and is Chairman of its Subcommittee on Taxation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Boren from page 1

legislation that was reported by the Senate Finance Committee in late July included those provisions.

Before enactment of the Tax Reform Act of 1986, donations of appreciated property, such as art, securities, and real estate, to colleges, universities, and other nonprofit organizations were deductible in the amount of their fair market value at the time of the gift. For example, if an individual purchased an artwork for $1,000 and gave it to a university several years later when its fair market value was $10,000, that individual would have been entitled to a charitable contribution deduction of $10,000. The 1986 Tax Act, however, limited charitable contribution deductions for taxpayers subject to the alternative minimum tax to the amount of the property's original cost to the donor. Thus, in the example I just gave, the donor's deduction, assuming he or she is subject to the alternative minimum tax, would be $1,000 (instead of $10,000).

The Tax Reform Act of 1986 contained two provisions that were particularly detrimental to institutions of higher education. One dealt a blow to donations of appreciated property to nonprofit organizations, and the other hurt tax-exempt bonds issued by private colleges and universities.

The 1986 "reform" has led to a precipitous decline in gifts of appreciated property, although other types of charitable giving has remained vigorous. Colleges and universities throughout the nation have identified repeated instances where potential donors changed their minds or altered their gifts solely because of this change in the tax code.

In 1990, the Congress partly undid the damage caused by the 1986 Tax Reform Act by restoring temporarily full deductions for gifts of "tangible" property such as artworks and manuscripts. This provision already has resulted in a dramatic turnaround in gifts made to museums during 1991 and the first six months of 1992.

I believe that it is very important for this relief to be extended to gifts of securities and real estate, as well as to gifts of tangible property, because these donations are crucial to educational institutions. The legislation that I have introduced, along with Senators Danforth and Moynihan, would restore permanently the full fair market value deduction for all gifts of appreciated property. Thus, gifts of artworks, collectibles, securities, and real estate all would be deductible at their full market value, rather than their cost to the donor.

Gifts of artworks, collectibles, securities, and real estate all should be deductible at their full market value, rather than their cost to the donor. This legislation needs to be enacted as soon as possible because we no longer can allow our great institutions of learning, art, and science to languish because the tax code punished the generosity of private citizens.

I am convinced that such legislation will result in a significant increase in charitable contributions to our nation's colleges and universities. This legislation needs to be enacted as soon as possible because we no longer can allow our great institutions of learning, art, and science to languish because the tax code punished the generosity of private citizens.

The second part of our legislation is vital to the continued well-being of our private colleges and universities. It would repeal the provisions of the Tax Reform Act of 1986 that arbitrarily capped the amount of tax-exempt bonds that private colleges and universities may issue, allowing these institutions to use tax-exempt bond financing in substantially the same manner as their public counterparts.

The practical effect of the $150 million bond financing cap that the 1986 Tax Act placed upon private institutions of higher learning has been to deny tax-exempt financing to large, research-oriented institutions most in need of capital to carry out their research mission. Currently, twenty-four private colleges and universities are at, or near, their bond financing cap and, thus, are foreclosed from using additional tax-exempt debt. If these institutions have to resort to more costly forms of financing, the result undoubtedly will be delays in renovation and construction that is badly needed to meet educational challenges in the years ahead.

The disparity in the treatment of tax-exempt bond financing between public and private institutions of higher education is a situation that should concern us all. The United States is unique in the roughly equal distribution of higher education between public and private institutions. This characteristic of our educational system has played a key role in the level of excellence it has achieved. By repealing the cap on tax-exempt bond financing for private colleges and universities, we can help to ensure that both the public and private sectors of higher education remain vigorous.

In conclusion, the enactment of tax provisions that encourage charitable donations and that allow capital financing at lower cost through the issuance of tax-exempt bonds is a way in which the government can effectively and appropriately enhance the ability of all colleges and universities to fulfill their important mission. ■

Our legislation ... would repeal the provisions of the Tax Reform Act of 1986 that arbitrarily capped the amount of tax-exempt bonds that private colleges and universities may issue, allowing these institutions to use tax-exempt bond financing in substantially the same manner as their public counterparts.

Typical American Family Finds Itself $214 Poorer in 1992

According to a new Tax Foundation study, weak income growth, inflation, and accelerating taxes will make the typical family $214 dollars poorer in 1992. Titled *Value of Typical American Family's 1992 Income Eroded by Taxes and Inflation*, the report defines a typical family as a household with two earners employed full-time, year-round and two dependent children. This family has lost purchasing power every year since 1989, for a 4-year loss of $1,444 (see table).

The two-earner family that made $33,492 back in 1982 is now earning an estimated $53,984, but when federal taxes, state and local taxes, and inflation are taken into account, this sizeable $20,492 increase in family income results in a real gain of only $4,021.

The Economic Recovery Tax Act of 1981 (ERTA) and the Tax Reform Act of 1986 (TRA'86) lightened the family's federal income tax burden, from a high of 17 percent of the family's income in 1981 to its current level of 12 percent. But this relief has been overwhelmed by the rising toll of Social Security taxes, federal excise taxes, and state and local taxes.

The combined Social Security tax rate has increased six times since 1981, up from 6.1 percent in 1980 to 7.65 percent today. More earnings are automatically subjected to the tax every year, so that Social Security's bite out of the typical family's income has reached a record $4,130 in 1992.

But individual income taxes and Social Security "contributions" are only part of the federal tax take. Indirect federal taxes — the employer's share of Social Security; business taxes; and excise taxes on a multitude of products — mean lower wages and salaries for workers, higher prices for consumers, and lower returns for investors. The Omnibus Budget Reconciliation Act of 1990 increased many of these, notably on gasoline (9 to 14 cents per gallon), cigarettes (16 to 24 cents per pack), beer (16 to 32 cents per 6-pack), wine (3 to 21 cents per bottle), and the telephone excise tax (permanently 3 percent). All told, the median family examined here will pay $5,832 in indirect federal taxes in 1992, or 10.8 percent of the family's income.

Higher state and local taxes are also causing the decline in the family's after-tax income. Just since 1990, states have added $37 billion in new taxes. Total state and local taxes that claimed 8.9 percent of the family's earnings in 1982 now commandeer 9.8 percent, or $5,282.

The Impact of Inflation

Inflation stood at 13.5 percent in 1980 but declined steadily to a low of 1.9 percent in 1986, giving the growth rate in family income a chance to outpace inflation. It was during this period that the family achieved its most significant gains, with real income rising an average of $911 per year between 1983 and 1988. However, inflation has since accelerated slightly and combined with a weak economy to reverse the trend. Inflation is estimated at 3.16 percent for 1992.

Taxes Dominate the Family Budget

Federal, state, and local taxes together are the largest item in the family's 1992 budget — 39.7 percent — more than on food, clothing, and housing combined. After paying its tax burden and purchasing these necessities, the family has only 29 cents left on a dollar to pay for such items as health care, transportation, and insurance. Not surprisingly, the family's current savings rate is less than 3 percent.

The outlook for family purchasing power is bleak. Persistent federal deficit spending over $350 billion means more pressure to raise federal taxes, and a similar situation prevails at the state level. These demands on the family paycheck, along with inflation and slower income growth, are likely to make the next few years tough sledding for the typical American family. ■

Two-Earner Median Family Income Before and After Taxes and Inflation

1980–1992

		Federal Taxes						After-Tax Income		
		Direct Taxes								
Year	Two-earner median family income (a)	Income Tax (b)	Social Security	Indirect Taxes (c)	State & Local Taxes (d)	Total Taxes	Effective Rate	Current Dollars	Constant 1992 Dollars (e)	Real Income Gain or (Loss)
1980	$29,669	$4,849	$1,819	$3,076	$2,547	$12,291	41.4%	$17,378	$29,631	
1981	32,283	5,610	2,147	3,466	2,763	13,986	43.3	18,297	28,280	($1,351)
1982	33,492	5,219	2,244	3,457	2,985	13,905	41.5	19,587	28,518	238
1983	35,440	4,991	2,374	3,802	3,187	14,353	40.5	21,087	29,746	1,227
1984	38,267	5,497	2,679	4,028	3,435	15,639	40.8	22,628	30,599	853
1985	40,213	5,785	2,835	4,380	3,632	16,632	41.3	23,581	30,791	192
1986	42,326	6,123	3,026	4,434	3,891	17,474	41.2	24,852	31,859	1,068
1987	44,981	5,655	3,216	4,833	4,149	17,853	39.6	27,128	33,552	1,693
1988	47,445	5,828	3,563	5,148	4,293	18,832	39.6	28,613	33,983	431
1989	49,058	6,178	3,684	5,264	4,462	19,588	39.9	29,470	33,391	(592)
1990	50,898	6,562	3,894	5,311	4,646	20,413	40.1	30,485	32,771	(620)
1991	52,579	6,383	4,022	5,552	4,871	20,828	39.6	31,751	32,753	(18)
1992 (f)	53,984	6,201	4,130	5,832	5,282	21,445	39.7	32,539	32,539	(214)

a) Median family income for household with two earners, employed full-time, year round.
b) Married couple filing joint return, two dependent children.
c) Estimated average indirect federal taxes. Includes excise taxes, employer's share of Social Security taxes, allocated corporate taxes, and miscellaneous levies.
d) Estimated national average of total state and local taxes.
e) Adjusted by Consumer Price Index (CPI-X1), estimated 3.16% inflation in 1992.
f) Estimates based on first and second quarter 1992 statistics.
Sources: Tax Foundation; U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Treasury Department, Internal Revenue Service.

Smith Promotes 1040 Checkoff As Strategy for Taxpayers to Pressure Lawmakers on Debt and Spending Reduction

On October 2, Director of Fiscal Affairs Paul G. Merski interviewed Senator Robert C. Smith on the Taxpayer Public Debt Reduction Act, a proposal Senator Smith has introduced to allow taxpayers to designate a portion of their income tax payments for debt and spending reduction.

Q President Bush recently announced in his Agenda for American Renewal that taxpayers should have the right to direct their tax payments to reduce the debt. This announcement has sparked great interest in your Taxpayer Public Debt Reduction Act which has also been proposed in the House by Rep. Robert Walker (R-PA). How would your proposal allow typical taxpayers to participate in reducing the national debt?

A All taxpayers, by means of a simple checkoff on their tax return, could dedicate an amount of up to 10 percent of their tax liability specifically toward the payment of the federal budget deficit. When the deficit is paid down and the budget is balanced, the funds would then go toward reducing the national debt, which is now well over $3 trillion. This would not represent any new tax money. It is simply a matter of voluntarily choosing anywhere from 1 to 10 percent of your existing tax liability to help reduce our record debt level. For example, if you had a $5,000 tax liability, then you could designate up to $500 of that to go directly toward debt reduction.

The key is that it's a voluntary proposal that lets taxpayers get directly involved. It's an empowerment issue on the part of the taxpayers. The President has taken a firm stand on it and is in favor of giving taxpayers that voluntary responsibility to make a difference in how their tax dollars can be spent. I think the important point on this proposal is that nothing is mandated until the taxpayers designate it by exercising their checkoff option.

Q Your proposal also attempts to curtail the spending growth of the federal government. How would this be accomplished?

A Controlling runaway federal spending growth is a major reason why I introduced this proposal. By checking off an amount to go toward debt reduction, each individual taxpayer would simultaneously authorize a corresponding dollar-for-dollar reduction in federal spending, except for spending on Social Security, mandatory interest payments on the debt, and, federal deposit insurance. On May 1st of each year, the Treasury Department would be required to provide Congress with an estimate of the total amount of money taxpayers have designated. Congress would then have from May until the end of the session to find the spending reductions in the budget for the next fiscal year. This would enforce taxpayers' wishes that this money reduce government indebtedness and spending growth.

At left, Senator Robert C. Smith (R-NH) explains his Taxpayer Public Debt Reduction Act to Tax Foundation Director of Fiscal Affairs Paul Merski.

Let's say that the taxpayers checkoff $25 billion for debt reduction. The Congress then would have the option through the current spending caps in the budget, or in any way that it sees fit, to set priorities on how best to reduce budget spending growth by $25 billion. If it doesn't make the reduction, then automatic across-the-board cuts would kick in. Also, all spending cuts would be permanent, which would help reduce the annual spending baseline.

Q Wouldn't tax increases simply be enacted to make up for any targeted spending reductions as a result of your legislation?

A The answer to that is no. The Congress has always had the option to raise taxes any time it chooses. Unfortunately, that seems to be very prevalent around here. But even if it does raise taxes, those tax increases cannot replace the cuts that must be made. So, Congress would have a very difficult time explaining to taxpayers why it raised say $25 billion in taxes even though the taxpayers specifically directed it to reduce spending growth by $25 billion. So, the answer, very simply, is that Congress can raise taxes, but tax hikes cannot be applied to offset the cuts mandated by taxpayers.

Q This year the federal government will run a $400 billion deficit, and the total debt held by the public will exceed $3 trillion. Is it possible for your Debt Reduction Act to make a significant dent in these numbers?

A It sure can, and I think that's one of the reasons why the tax-and-spend liberals are so fervent in their opposition. There are approximately 110 million taxpayers in America who pay about $500 billion in income taxes. If everybody chose to check off the maximum 10 percent, which is unlikely, then according to the calculations of the Congressional Budget Office, the budget could be balanced within four years, and the national debt itself could be totally eliminated before the year 2010. That's how dramatic the effect of this legislation could be.

Now, you can speculate and say, well, if taxpayers only choose 5 percent instead of 10 percent, then debt and federal spending would be reduced by $25 billion each. You can easily do the mathematics, and you can see at what rate we would reduce the debt. But the greater point is that taxpayers set the pace. In spite of Congress, taxpayers can reduce runaway federal spending and the nation's record debt. This will produce permanent cuts, and the interest payments on the debt will also go down sharply as we reduce the debt, adding up to significant savings. We could save $15 or $20 billion dollars a year in interest expenses alone.

Q Why would buying down existing federal debt be beneficial if it is simply offset by new debt?

A Obviously, if Congress continued to incur more debt, then it would not be beneficial. We are already spending over $200 billion per year just on interest costs — one in seven dollars sent to Washington goes for interest on the debt. Buying down the debt is what this proposal empowers taxpayers to do. Now, if Congress goes ahead and borrows more money, it will have to answer to the public who mandated the exact opposite action.

The bottom line is that reducing federal spending growth and buying down the debt is beneficial. If Congress adds new debt, then it will have ignored the intent of the law, which is what it did with Gramm-Rudman. But, if it ignores the law this time, it will be ignoring the will of the taxpayers and the Congress will do that at great peril.

Q In 1987, Congress did scrap the original Gramm-Rudman deficit targets because it was unable to stomach $16 billion in spending cuts. If taxpayers fully participated in the plan, would the resulting $50 billion in spending cuts likely be allowed by Congress?

A Congress did walk away from the spending control of Gramm-Rudman. It walked away from it because it did not have the guts to face the hammer of the sequester, which legally could have achieved a balanced budget by today. The law was good but Congress didn't have the courage to enforce it. In this case, however, the hammer is the taxpayers themselves.

If taxpayers fully participate in the plan, they will mandate $50 billion in budget savings. Congress has to produce these savings unless it specifically changes the law again. This could only be done with great peril because this time it's the taxpayers saying they want a $50 billion cut this year. So with taxpayers mandating the cut each year, Congress will have to comply or the public will respond accordingly at election time. That is how the process should work.

Q How would you respond to those who say your bill is "unfair" because it allows individuals with tax liabilities to initiate spending cuts that affect people without income or who do not need to file a tax return?

A While someone with a larger tax liability could designate more money for debt reduction, the checkoff proposal is fair because that individual cannot designate what program should be targeted for spending reductions. The individual taxpayer could not say "Cut defense, cut environment, cut education, or cut Social Security." A person can simply say I am designating a certain percentage of my taxes to reduce the debt and to slow the overall growth rate of federal spending. Congress will still have a free hand in deciding the spending levels of specific programs through the budgetary process.

Q Other checkoff options on the individual tax return have been declining in popularity. Does your plan differ from these types of checkoffs and do you have any estimates on the likely participation rate in your debt reduction option?

A A national survey conducted in September indicated that 70 percent of individuals viewed the check-off option as a good idea. I have not seen any scientific analysis on specifically how many people would participate. However, I think this idea will start slowly and catch on because as people see the debt actually going down due to their participation, they are going to start talking about these positive results at the dinner table, and the work place. They are going to realize that they are directly responsible for debt reduction. As with any new idea, there is skepticism at first, but I think momentum will grow. Many American taxpayers will do it because they are sick and tired of seeing a selfish Congress passing on debt to our children. This is a way to go around Congress and say you're not doing the job, but we are going to get the job done. Unlike other check-off options on the tax return, this is the only one that is not calling for additional spending, but, instead, it mandates spending restraint.

Q What level of support has your debt reduction plan received from your colleagues and from taxpayers around the country?

A My mail has been overwhelmingly favorable. We have done talk shows in my state and around the country explaining this proposal, and the response has been phenomenal. The White House has received positive feedback from the President's endorsement of this option. However, it is interesting to see how a proposal that is supported overwhelmingly by the taxpayers is not supported by the majority of the United States Senate. I don't object to a difference of opinions in this country — that's democracy. But what I object to is insulting taxpayers by refusing them the option to reduce the debt. This proposal would not reduce spending one nickel if taxpayers did not choose to do so. I am going to try to give taxpayers the right to do that. They are tired of politicians talking about the dangers of runaway spending and not doing anything about it. ■

Tax Foundation's
55th National Conference and Annual Dinner

New Directions in Tax Policy

Wednesday, November 18, 1992, The Waldorf-Astoria, New York City

The Waldorf-Astoria is located at 301 Park Avenue, New York, NY 10022

Registration/Light Fare	12:00 noon	Jade Room
Conference Sessions	1:00 p.m.	Jade Room
Reception	6:00 p.m.	Hilton Room
Dinner (Black Tie optional)	7:00 p.m.	Empire Room

- Professors and students can participate in the conference through the Foundation's College Classroom Program.
- Reservation deadline for the block of rooms reserved by the Tax Foundation is November 1, 1992. Call the Waldorf directly at 212/872-4534.
- Conference and dinner reservations should be received by November 13, 1992. (Written cancellations for refunds accepted through this date only.)
- Questions about the conference and dinner should be directed to: Michelle Rubin, 202/863-5454. Fax 202/480-8282.

12:00	**Registration**	***Light Fare***
1:00	**Welcome**	***Dan Witt*** Executive Director Tax Foundation
	Session I	***The Current State of Tax Policy***
	Panel Chairman	***Paul G. Merski*** Director of Fiscal Affairs Tax Foundation
	Speakers	***Ronald Pearlman*** Partner Covington & Burling
		Bill Frenzel Distinguished Fellow Tax Foundation
		Lawrence Kudlow Chief Economist Bear Stearns
		Norman B. Ture President, Institute for Research on the Economics of Taxation
3:00	**Break**	

3:15	**Session II**	***The Future of Tax Policy — Is the Present System in Need of Repair or Replacement?***
	Panel Chairman	***Floyd L. Williams, III*** Chief Tax Counsel Tax Foundation
	Speakers	***Harry L. Gutman*** Chief of Staff Joint Committee on Taxation
		R. Glenn Hubbard Deputy Assistant Secretary Office of Tax Analysis Department of the Treasury
		Rudolph G. Penner Director of Economic Studies KPMG Peat Marwick
		David Bradford Member Council of Economic Advisers
		Robert J. Shapiro* Vice President for Economic Studies Progressive Policy Institute
5:00	**Adjournment**	

** Invited*

Registration Form

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Conference Fee:
Member/$100, Non-Member/$150
Reception/Dinner: $250

Tax Foundation's National Conference In NYC To Chart New Directions In Tax Policy

The Tax Foundation will hold its 55th annual conference and dinner on November 18, 1992, at the Waldorf-Astoria Hotel in New York City.

The conference, titled "New Directions in Tax Policy," will explore the legacy of the 1980s and plot a course for the rest of the 1990s. (See registration form opposite.)

Eleven years ago, a major tax cut led the U.S. out of its last recession, and in a decade of frenzied tax and fiscal policy activity, the economy sustained 92 consecutive months of growth. This period included a major restructuring of the tax code in 1986 which lowered marginal rates dramatically. Many nations followed our lead and cut their marginal rates.

The first session will assess the impact of the major tax legislation enacted during the past decade, with emphasis on the benefits and shortcomings of the Reagan/Bush economic agenda.

Ronald Pearlman of Covington & Burling, Bill Frenzel of the Tax Foundation, Lawrence Kudlow of Bear Stearns, and Norman B. Ture of the Institute for Research on the Economics of Taxation will draw the relevant lessons from the decade of the 1980s.

The second panel will examine potential new directions in federal tax policy, including alternative tax systems that have received more attention in light of heightened global competition.

David Bradford of the Council of Economic Advisers, Harry L. Gutman of the Joint Committee on Taxation, R. Glenn Hubbard of the Department of the Treasury, and Rudolph G. Penner of KPMG Peat Marwick are slated to outline policies the U.S. needs to adopt to steer the country out of its current economic doldrums.

In the evening, the dinner will feature the presentation of Distinguished Service Awards to both Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, and Allen Murray, Chairman of the Board, President and Chief Executive Officer of Mobil Corporation (see page 8). ■

FOUNDATION MESSAGE

Reducing the Regulatory Burden for Small Business

Floyd L. Williams, III
Chief Tax Counsel

The current Administration has stated that reduction of the regulatory burden for small businesses is an integral part of its economic agenda, in recognition of the fact that two-thirds of all new jobs are created by small businesses. The Treasury and the Internal Revenue Service have recently taken a significant step in this regard by issuing new, simplified payroll tax deposit rules for employers. These new rules will reduce the costly burden of needless paperwork and confusing red tape for millions of small businesses. The rules are simpler, more user-friendly, and will ease compliance.

The existing payroll tax deposit rules are quite complex and require employers to monitor constantly the amount of accumulated taxes withheld from employees' paychecks. In some cases, payroll tax deposits can be required eight times each month, and the deposit schedule can change frequently. According to the IRS, employers have had so much difficulty meeting the deposit requirements that 30 percent of all employers required to make deposits were penalized annually for inadequate or late deposits.

Last May, the IRS proposed changes that were intended to simplify and standardize the payroll tax deposit system, and asked for comments from the public, business representatives, and payroll processors. The new rules will take effect on January 1, 1993, but provide a one-year transition period for employers to change their payroll systems.

Under the new regulations, which were issued on September 22, 1992, employers generally will deposit withheld taxes either on a monthly or semi-weekly basis. Determining which deposit schedule applies will simply require looking back at the employment taxes reported for a 12-month look-back period (July 1 - June 30 of the prior year). By November of each year, the IRS will notify employers which schedule to follow for the coming year.

Employers who reported $50,000 or less during the look-back period will be monthly depositors. According to the IRS, this category will include 75 percent of all employers (and most small business employers). The deposits for these employers will be due by the fifteenth day of the following month.

Employers who reported $50,000 or more during the look-back period will be semi-weekly depositors. For Wednesday, Thursday, or Friday paydays, the deposit will be due by the Wednesday after the payday. For all other paydays, the deposits will be due by the Friday after the payday.

The new regulations carry over some special rules and exceptions from the present regulations. For example, employers accumulating $100,000 during a monthly or semi-weekly period must make deposits by the next banking day. Employers that accumulate less than $500 during the quarter can skip making deposits altogether and send full payment with their quarterly employment tax returns.

A safe-harbor rule provides that an employer who underdeposits will not be penalized if the shortfall is $100 or less, or is less than two percent of the amount that should have been deposited. Finally, for purposes of the new rules, all new employers will be monthly depositors.

These new rules indicate that the government truly is serious about reducing the burdens on small businesses. Furthermore, they reflect the positive results that can be achieved when the government, the public, and the business community work together for a common goal.

Greenspan and Murray To Receive Foundation's Distinguished Service Awards at Annual Dinner

Alan Greenspan will address the Tax Foundation's 55th annual dinner in New York City on November 18, 1992, as he receives the Foundation's Distinguished Service Award for the Public Sector.

Alan Greenspan

In March, Greenspan began a second four-year term as Chairman of the Board of Governors of the Federal Reserve System. His current term as a member of the Board of Governors runs through January 2006.

From 1954 to 1974 and from 1977 to 1987 Greenspan was Chairman and President of Townsend-Greenspan and Co., Inc., an economic consulting firm in New York City. He served from 1974 to 1977 as Chairman of President Ford's Council of Economic Advisers and from 1981 to 1983 as Chairman of the National Commission on Social Security Reform.

He has also served as a member of President Reagan's Economic Policy Advisory Board, and a consultant to the Congressional Budget Office.

He was born on March 6, 1926, in New York City. He has his B.S., M.A., and Ph.D. in economics from New York University. ■

Also at the annual dinner, the Tax Foundation will bestow its Distinguished Service Award for the Private Sector on Allen E. Murray, Chairman of the Board, President and Chief Executive Officer of Mobil Corporation.

Allen Murray

Murray joined Mobil in 1952 as an accountant, was appointed general manager of the Middle East and Indonesian Affairs Department in 1967, and was elected a corporate vice president and appointed executive vice president of the North American Division in 1974.

He was appointed president and chief operating officer in 1983, and in 1986 he assumed his current position.

He is a director of the American Petroleum Institute, and a member of the President's Advisory Committee on Trade Policy and Negotiations, the Council on Foreign Relations, the Trilateral Commission, and the Chase Manhattan Bank International Advisory Committee.

He was born on March 5, 1929, in New York City. He received his B.S. degree in business administration from New York University in 1956. ■

Mark Your Calendar
for the
Tax Foundation's 55th Annual Dinner and Conference
November 18, 1992
at the Waldorf-Astoria in New York City

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